THE FEDERAL RESERVE BOARD

convenes the

PUBLIC HEARING RE:

BUILDING SUSTAINABLE HOMEOWNERSHIP: RESPONSIBLE LENDING AND INFORMED CONSUMER CHOICE

The verbatim transcript of the Public Hearing held before Charlene M. Hansard, CCR-CVR, Certified Court Reporter in and for the State of Georgia, at the Federal Reserve Bank of Atlanta, 1000 Peachtree Street, N.E., Atlanta, Georgia, at 8:30 a.m. on July 11, 2006.

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P R O C E E D I N G S

8:46 a.m.

MS. BRAUNSTEIN: Good morning, everybody. I think we're going to get started. And I'd like to welcome you to what is the final public hearing under the Home Ownership and Equity Protection Act or HOEPA as it's known. We have held three previous hearings: one in Chicago, one in Philadelphia, and one in San Francisco. And they've all been extremely helpful and extremely enlightening for us.

And we're looking forward to today's hearing because we have a lot of very good panelists that will be joining us during the day. And the purpose of these hearings is to really look at the home equity lending markets and the adequacy of existing regulatory and legislative provisions for protecting the interests of consumers, in particular, low and moderate income consumers.

What we've done through these hearings is really explore three major topics. We have been looking at the impact of the HOEPA rules, and that's both the federal HOEPA rules that we have, as well as other predatory lending laws that have been enacted on state and local levels. We've also been looking at non-traditional products. And as we know, there's been a real boom in the existence of non-traditional mortgage products, things like interest only loans, option ARMs, and other kinds of variations on those themes and an emergence -- a strong emergence of reverse mortgages.

And we've been looking at those products, too, and in particular, is there adequate information out there for consumers and do they understand the implications of these products. And we've also been looking at how consumers select lenders and products, especially in the subprime markets, how they go about shopping, if they shop, push marketing issues, and other issues around the whole issue of selection of products and services.

For these hearings we basically have four objectives. We want to try to assess the effectiveness of changes that we made to the HOEPA rules in 2002. We are required by statute to conduct these hearings on a regular basis. And frankly, the last time we did them was in 2000, and we purposely waited six years to do this because we wanted to wait to give time for the changes that we made in 2002 to take effect and to see if there's been any impact, either on the availability of credit to consumers or if there's been an impact on the lessening of abusive practices. And we've been talking about those issues.

We're also gathering information for a pending review that we are planning of regulation Z, in particular, the closed-end credit rules around mortgage disclosures. And we want to -- Through these hearings, another objective of ours is to determine where additional education, information, both materials, activities are needed and what those might be for consumers. And then also we're trying to identify where there are mortgage lending issues that would lend themselves to additional research and to try and encourage that research, possibly internally through the Fed or externally through other organizations. And I know today we're going to be spending quite a bit of time talking about research around consumer behaviors in our third panel.

These hearings are particularly important right now because of the development over the last years of extremely complex products. And on the one hand, that's been a positive development because certainly more people are getting credit and have access to credit than ever have before in history. However, we also know that if those products are not utilized appropriately, they can be fraught with problems for consumers and can have some bad results. So we really want to look at these issues and try to figure out, you know, what is best going forward and what we can do in terms of our authority as regulators.

This -- The whole mortgage lending process really has shared responsibilities. And there are roles obviously for the consumers through consumer education, through shopping, through finding out as much information as they can, through taking care of their personal finances and making sure that their credit records are the best that they can be, through the lenders for acting responsibly, for not abusing vulnerable consumers, for presenting information as clearly and as accurately as possible for consumers. There's also roles for consumer and community groups who have access to consumers and certainly present a lot of services to those consumers.

And then there's a role for the regulators. And that's what we're looking at, especially now is what our role is in terms of our rules and guidance and other kinds of things to help the markets run more efficiently.

So with that, I would like to introduce the panelists and talk a little bit about the procedures for today's hearing. My name is Sandy Braunstein. I am the director of the Division of Consumer and Community Affairs at the Federal Reserve Board in Washington, D.C. I will be chairing the hearing today.

With me from Washington from the Federal Reserve Board is Leonard Chanin who is the associate director of the Division of Consumer and Community Affairs, and he is associate director for the regulations area. And also with us is Jim Michaels, who is the assistant director for regulations in the Division of Consumer and Community Affairs. We are also joined by Joan Buchanan from the Federal Reserve Bank of Atlanta, and we're really pleased to have her here. And she's an assistant vice president and is over the consumer compliance area here at the Federal Reserve Bank of Atlanta. And let me just say that we want to thank the Federal Reserve Bank of Atlanta and all its staff for the excellent job they're doing of hosting us today and for allowing us to come here and have this hearing.

The way we're going to conduct this hearing is that we will go into our first panel and we -- each panelist will have five minutes for opening statements. We do have a time keeper. I want to alert the panelists to our time keeper, who's sitting right there with the box with the big light bulbs on top, should be very visible.

We are going to stick to the time table of five minutes for your opening. If you go past that, I will cut you off. But you can -- If you want to submit longer comments for the record, you can feel free to do so. And also, I want to let the public know that we're accepting public comments of any length -- public, written comments. You can feel free to submit those until August 15th is the deadline for that, and those can be any length you want.

So the panelists will have five minutes. The time keeper, Wayne, will give a yellow light at four minutes, when you have one minute left and then the red light when your time is up. And so I would ask you to kind of, as you're doing your remarks, keep an eye on the box.

We will have three panels today. And the topics that we're going to be discussing today are the first panel we're going to be talking about the HOEPA rules and other predatory lending laws, state and local, and the effectiveness and where we may need to do some other kinds of things and what else is needed in the markets. We're going -- The second panel will deal with the non-traditional mortgage products. And the third panel is going to be discussing research on consumer behavior research.

At 3:00 o'clock today we will have an open mike session. And there is a sign-up sheet outside in the hallway for that. If you want to speak, anyone who wants to can speak during the open mike session, but you need to sign up on the sign-up sheet.

Each speaker will have three minutes for their remarks. And there again, if you have longer remarks, you're welcome to submit them in writing for the record and we will accept those until August 15th. But I will remind -- make periodic reminders during the day about the open mike sign-up sheet, so feel free to sign up.

And with that, I think we're going to start. What I would ask is for each panelist to introduce themselves. We're going to start from this end. Margot, you're going to go first. To introduce yourself and your organization for the record.

We also, by the way, have a court reporter here who's over there talking into the horn. And just also for the public to know that these transcripts, we are going to have transcripts of each of the four hearings. The transcripts will be public documents. We will be making them available on our website -- on the Federal Reserve website. So you're free to access those. It takes a few weeks to get them up and running. But we will have transcripts of all four hearings.

So for the record, I would ask that you state your name and your organization and then go into your opening remarks, and we'll start. Margot?

MS. SAUNDERS: Thank you, Sandy. It's nice to be here. I'm Margot Saunders from the National Consumer Law Center. There are piles of consumer loan documents on my desk and the shelves surrounding it in my little office. In the past few months alone I have closely examined the microscopic details of mortgage transactions from Pennsylvania, New Jersey, Georgia, West Virginia, Missouri, Ohio, Texas, Illinois, Virginia, Florida, as well as other states. So I feel like I have a pretty good hold on what's going on in the country in subprime mortgage lending, just from what comes across my desk.

These detailed analyses of dozens of home loans illustrate to me and to the National Consumer Law Center one overwhelming fact. The mortgage system in this nation is irretrievably broken. While the people sitting around this room may be able to obtain truly inexpensive non-abusive mortgage loans, that's not the case for the tens of thousands of subprime borrowers who are provided high cost loans for amounts they do not need stripped -- which strip precious equity from their homes to pay exorbitant fees and costs, secured by loans on homes which are not worth the amount of the loan.

The loans are generally priced much higher than equivalent mortgages in the prime market, but they're not priced this high because of the increased risk of the loan. They are priced higher because the originator can exact this extra amount from the homeowner. The price is not commensurate with the risk. The price too often creates the risk.

Consider these sad statistics. Of low income households who became homeowners, 64 percent remained after two years, compared with 88 percent of high income homeowners. Over five years 47 percent of low income homeowners remained in their homes compared with 77 percent of high income. Compare this information with facts we're all to familiar with, the scary increase in the raw number of foreclosures for all types of homeowners, and we're met with a new truth. Something new and different must be done to preserve home ownership.

The entire mortgage industry has figured out ingenious ways to make healthy profits from mortgage lending without suffering a risk of loss. We think that the subprime mortgage industry anticipates that there will be defaults and forced refinancings and foreclosures and that these anticipated losses are built into the cost of doing business. The industry then protects itself from the overall loss by charging everyone more. This means that the industry is deliberately making loans, knowing that one in eight, or thereabouts, of these loans will be headed to foreclosure.

The ability of the mortgage industry to protect itself from anticipated defaults and foreclosures by charging everyone a higher price creates a marketplace where the risks to homeowners are no longer parallel to the risks to the lenders. The losses caused by defaults and foreclosures to the industry are guarded against by simply charging more. But the losses to the homeowner, the family, and the community from these foreclosures is simply devastating. This is fine as a business model, but it's bad policy for the nation to allow it and facilitate it.

The mortgage industry uses deregulation, preemption of state consumer protection laws, the holder in due course doctrine, to evade responsibility for making these bad loans. But the prime rationale for the continued lack of regulation of mortgage lending is that we don't want to hamper the healthy mortgage market in this nation. We're here to tell you today that that's just what we want to do.

We must reign in the mortgage industry. It must be regulated. It does the low income family no good to invite them to participate in the American dream of home ownership only to allow them to be tricked out of that home within a few years.

Financial literacy is not the answer. Tweaking the federal laws that we have on the books that govern a small piece of the mortgage market like HOEPA is also not the answer. The mortgage market has changed significantly since HOEPA -- in the 14 years since HOEPA was passed. Problems have become much worse. We need wholesale significant regulation.

To maintain home ownership, to maintain the strength of home equity as a primary savings tool, the mortgage industry must be required to underwrite mortgage loans to ensure that the loan is appropriate to the -- for the household. To accomplish this, we need strong but deliberately vague standards like suitability to apply to all loans. Additionally, all players in the mortgage market must be part of the solution, just as they're now part of the problem. There must be full assignee liability applied to every mortgage loan.

We commend the Federal Reserve Board for the substantial improvements to HOEPA and the aggressive regulation of mortgage lending under HOEPA that you have done since it was passed. These changes did -- The changes in 2001 did have some positive affect on the industry, specifically in the way they helped dry up the sale of abusive credit insurance premiums. Now, we ask the Federal Reserve Board to recognize the overall mess that the market is in and to recommend to Congress that significant changes be made in the regulation of mortgage lending. Thank you.

MS. BRAUNSTEIN: Thank you, Margot. Barbara?

MS. KENT: My name is Barbara Kent. I am from the New York State Banking Department, and I'm here today on behalf of the department and CSBS, the Conference of State Bank Supervisors and thank you, I'm very pleased to be here.

When the Home Owners Equity Protection Act was first enacted, it was an excellent first step. It focused attention -- Oh, that wasn't smart. It focused attention on the problems associated with high cost home loans, and it provided a model of how to prevent abuses of such loans.

And yet, HOEPA as originally enacted or as amended has had very little impact on subprime lending. Even when interest rates were much higher than they currently are, very few loans were priced either above the APR or the points thresholds set forth in the statute. Moreover, the statute did not address yield spread premiums or single premium credit insurance. And open end credit plans, including home equity loans, were not subject to the law.

Because of the high statutory thresholds, the loan could be priced below the thresholds and yet, in truth, still be an expensive loan. As a result, when the banking department conducted its examinations of certain mortgage lenders, we often found loans that were high priced but just below the HOEPA thresholds so as to avoid compliance with the law. Similarly, a large nationwide lender, among others, used the fact that home equity loans were not covered to create -- were not covered, created what were termed piggyback or side-by-side loans.

If a borrower sought to refinance a loan, he or she actually obtained two loans. The first loan, which was for the majority of the amount sought, was priced to fall below the HOEPA thresholds and, therefore, not be subject to the law. The balance of the amount sought was lent in the form of a high-priced home equity loan that almost always was nearly entirely disbursed at closing. However, since it was a home equity loan, the points and interest rates were immaterial. The loan was not covered by HOEPA.

The more we examined these loans, the more convinced we became that despite HOEPA, many -- many loans had no apparent benefit to the borrower and demonstrated patterns of abusive lending practices. But the loans were in perfect compliance with the then existing state laws and regulations that were hired -- highly disclosure oriented. Clearly, other action was needed, and the state stepped into the void to take this other action. They sought to curtail predatory lending by enacting regulations and statutes on the state level.

North Carolina adopted a statute modeled on HOEPA, but which went significantly further. There were draconian predictions that subprime lending would dry up in North Carolina, a contention that North Carolina vigorously disputes and claims is not true. For us in New York, the action was -- the decision we had to make was what action could we take that would not dry up credit and yet stop abusive lending.

Ultimately, we adopted a regulation which then a few years later in 2003 became a statute. The statute had -- was modeled after HOEPA but had significant differences. During this time period, many other states also adopted state statutes. And they tended to have a lot of things in common in their differences from HOEPA. They had lower APR thresholds, lower point thresholds.

They -- In New York home equity loans were included, financing of single premium credit insurance was prohibited, yield spread premiums were included in the definition of points and fees, and there were numerous prohibitions of a substantive nature on what it meant to be affordable and what it meant to -- what you could do as a lender if you were refinancing a loan. And yet, similarly to HOEPA, the new law and regulation -- excuse me -- has also had unlimited impact on the marketplace.

The interest rate environment is fairly low and continues to remain fairly low. And so, loans are being made right below the threshold -- right below the threshold set forth in the statute. This allows loans to continue to be made that are -- have abusive lending practices within them. In addition, we now have all sorts of new products on the market, which we believe are dangerous to the -- to the unsophisticated borrower.

As a result, we believe that although there have been many improvements made, there have been enforcement actions that some practices that were common not too long ago have changed and that in some respects, the mortgage market is better than before, that further changes are needed to protect consumers and home buyers from the products that are right below the threshold and from the new interest -- new types of mortgage products. Thank you.

MS. BRAUNSTEIN: Thank you. Bill?

MR. BRENNAN: My name is Bill Brennan. I'm happy to be here today to tell you what we're seeing. I've been the director of Atlanta Legal Aid's Home Defense Program for 18 years. We screen and take on cases involving predatory mortgage lending, foreclosure rescue scams, and home purchase fraud. We help a lot of homeowners facing foreclosure.

We've investigated hundreds, maybe thousands of mortgage loans over the years. From our vantage point we get a real sense about what's happening on the ground with mortgage lending in the metro Atlanta area. Here is what we are seeing.

For the past four or five years, above all other lending abuses we see, we have seen a huge increase in lending without regard to the borrower's ability to pay. To the extent that for all the intake we do with clients, the first question we always ask is -- of our clients is, what was your income when you got the loan, what was the loan amount, and your monthly payment. The answer is virtually always the same. They have loans they can't afford.

Just as credit card banks 20 years ago made an intentional conscious corporate decision to begin lending without regard to the customer's ability to pay, to issue multiple cards to individuals, to drastically raise credit limits, in short to increase volume as a way to dramatically increase profits knowing that the defaults would also increase, but choosing to let that happen in the service of the higher goal of increased profits, we now see the mortgage lenders, particularly subprime lenders, intentionally deciding to go down the same path with tragic consequences for home buyers and owners.

What we see is that the mortgage lending system isn't working. As Margot said, it's broken. Underwriting doesn't exist. Applications are falsified as to income and assets. Actual income is grossly inflated. False jobs are listed. Suitability goes out the window.

The result: loans made to borrowers who can't pay; working class people, home buyers, and homeowners refinancing with mortgages the lenders know will fail. Especially despicable is lending to seniors and disabled homeowners living on limited fixed income, Social Security, and/or retirement income with refinances at amounts they could never afford. A thousand a month income, 850 a month in mortgage payments.

Adding insult to injury, we see these loans with ARM features. ARMs should never be made to people living on fixed incomes. They get these loans. They struggle to make the payments. When the interest increases, as it has for two years now, they tumble over the cliff. They face foreclosure.

We see the -- By the way, the vast majority of clients that we see are African-Americans, Latin Americans, seniors, and disabled people. These are the folks that are losing their equity, losing their homes. People like Ms. Eloise Manuel and Agnes Martin, who you will hear more about in the open mike session this afternoon.

Because of this broken system, foreclosures are rampant. We are inundated with calls and walk ins in the weeks before the first Tuesday of the month, foreclosure day in Georgia. In Fulton County where Atlanta is located, foreclosure ads reached their highest level in history, over 1,000, for the June '06 foreclosures.

Here's what we found in looking at these. We have a chart on it. The bulk of these loans were originated in '05. That means these loans aren't even lasting one year.

Why is this happening? We think we know why it's happening. Because lenders have stopped underwriting, just like the credit card banks have done. Driving this trend of irresponsible lending is the system of bundling these mortgages into pools and selling securities to investors. Securities which are collateralized by the mortgages in the loan pools. This has increased profits for originators providing more capital to lenders and increased profits for investors. The words goes out, we need to fill the pools.

But here's what we're seeing. There are not enough eligible borrowers out there. Many are already maxed out or fully mortgaged or are really not qualified for a mortgage loan, but originators push market these loans to the unqualified. Everyone profits except those who are clients like our elderly African-American widow who loses a home she has owned for 30 years because of a bad loan. Where does she fit into this securitization scheme? We would like to know.

Who buys these securities? One big concern we have is that Fannie and Freddie are not only purchasing more and more subprime high cost abusive loans, they are major purchasers of the subprime securities issued. And they are, therefore, capitalizing predatory lending in a huge way, providing capital to this -- to sustain this broken system that doesn't work to benefit borrowers.

What is the impact of HOEPA and the Georgia Fair Lending Act, which we call GAFLA? Pretty much meaningless, I have to tell you. We look at cases week in and week out, and these laws do not help us see the abuses that we're seeing, especially lending without regard to the ability to pay.

Here's what we recommend. Laws which mandate a return to legitimate underwriting and suitability standards. Laws, for example, that would ban mixing ARM loans -- making ARM loans to homeowners living on low fixed income. We also recommend laws which would simply ban all abuses for all loans. For example, laws should outlaw lending to borrowers who can't pay and not qualify the prohibition by requiring proof of a pattern and practice. Just make it illegal in every case, period.

We need laws which allocate risk fairly among the participant -- among all the participants in the process, not heaping the risk on the homeowners with no risk for others down the line. Therefore, laws must impose assignee liability for violations. Purchasers of loans and investors in securities will not participate in the system if this happens, and we think that's the way to stop these poisonous loans being marketed to vulnerable homeowners. Thank you.

MS. BRAUNSTEIN: Okay. Thank you very much, and we'll get back to a lot of those issues. Gail?

MS. BURKS: Good morning. My name is Gail Burks. I'm president and CEO for Nevada Fair Housing Center, Las Vegas, Nevada. I also serve on the board of the National Community Reinvestment Coalition and Economic Justice Trade Association with over 600 members across the country.

We've submitted written comments, and I've divided my public comments today into four sections. First, I'd like to talk about the emerging legal trends that we're seeing and why current law is not adequate; second, the inadequacy of state anti-predatory lending statutes; third, the economic impact of not doing anything; and then look at proposed solutions that we think would fix the problem.

There's been an emerging trend in consumer abuses since 2001, when we first started to address predatory lending issues. In Las Vegas in the anti-predatory lending program that we operate, we have seen that subprime lending is generally where many of the predatory lending problems start. Now, we need responsible subprime lending. It's a necessity.

But when a disproportionate amount of loans -- subprime loans are made to persons in protected class groups that's where we have a problem. For example, when we look at 2004 Las Vegas HMDA data, we see disparities among borrowers of varying races. 23.22 percent of the loans made -- of all loans made were -- of subprime loans made were made to Hispanic borrowers. 22.46 percent of all loans made were subprime, and those were made to African-American borrowers. 18.14 percent of all loans made were subprime and made to Native American borrowers.

In short, there's a disparity of about 10.61 percent between Hispanics and whites and a difference of 19.07 percent in first liens to African-Americans, and that's when you control for income. So it's not just about low income people. It crosses income lines.

On a national level from 2004 -- February 2004 to

June 2006, the National Community Reinvestment Coalition conducted a study in several large metropolitan areas -- LA, Chicago, St. Louis, and Atlanta -- and documented the differences in treatment based on race by brokers. Brokers make up 70 percent or account for 70 percent of the loans made in this country. So any regulation has to include a coverage for brokers.

In that study it was found that 73.3 percent, when you control for race, in the control groups 73.3 percent of the control group of whites were given or had all types of loans discussed. However, when you look at the protected group, African-Americans, only 30.6 percent of that group received information about all available loans.

If we turn to the other issue and perhaps the biggest trend in predatory lending since 2001 and look at the back end, the servicing, we see a huge increase in foreclosures and a huge increase in abuses. Some of the abuses that we see in Las Vegas and around the country include the failure to credit payments properly. We see agencies popping up with government sounding names, such as the Fair Lending Assessment Center, that offers to assist consumers who are in foreclosure. But actually what happens is it results in the transfer of the consumer's property generally without their knowledge through the use of powers of attorney and through the use of other scams that basically places the scammer's name on the property.

We also see an increase in the payment just to get a forbearance agreement. In the end, forbearance agreements result in foreclosure, especially in non-judicial foreclosure states when consumers are unable to complete the forbearance agreement that was improper and violated circumstances in the first place. With respect to state laws, there are only seven states that have good anti-predatory lending laws, and Nevada's not one of them. And that results in an issue, as well.

Finally, some of the solutions. We think we have to have a law that has assignee liability, but we also have to have the ability to resolve cases, in other words, to provide consumers a choice in terms of the avenue for resolving their foreclosure problem. Even though we have the right of rescission currently under truth and lending, a consumer still has to have a loan if the original loan is rescinded.

We think we need to improve disclosure, we need to include broker fees and YSPs, even those paid by the lender in any legislation we adopt, and we need to enhance the quality of HMDA. We need to look at credit scores in order to determine what classes are receiving adequate loans.
Thank you.

MS. BRAUNSTEIN: Thank you. Harry?

MR. DINHAM: Yes, ma'am. Good morning. I am Harry Dinham, president of the National Association of Mortgage Brokers. Thank you for inviting NAMB to speak on the impact of federal, state predatory lending laws and developments in subprime lending.

NAMB is the voice of the mortgage broker industry. We have a longstanding commitment to a professional and ethical industry that serves the consumer. We, too, are troubled by the actions of a few bad actors that inhabit every single segment of our mortgage marketplace, be it broker, mortgage banker, lender, or depository banker. NAMB believes to truly resolve the issues of today, we must have a joint effort from all three components of the marketplace: the government, the industry, and the consumer.

Unfortunately, many industry critics have based all the problems that consumers have with the current shopping process, products, and disclosures within one point of this triangle, the industry. In doing so, they have ignored a vital role that government and consumers have throughout the loan origination process. NAMB believes any proposed solution should involve all three points of the triangle.

First the role of government. We have witnessed a great expansion in our mortgage finance industry, expanding product choice and distribution channels, adding robust competition, and greatened pricing options. Unfortunately, this expansion has led to some corresponding rise in the number of uneducated and unlicensed originators. While states are increasing requirements for brokers, they continue to exempt officers of banks and lenders from important standards.

I make this point because consumers do not know the difference between a broker, mortgage banker, lender, or even a depository banker. There's little difference between them. We are all competing distribution channels.

This is why government should ensure that every single mortgage originator is licensed and required to complete both pre-employment and continuing education requirements. Consumers deserve an educated originator, regardless of the distribution channel chosen. Every originator should also submit to criminal background checks so that bad actors do not move freely from one channel to another.

We must also create and implement a well-designed, well-tested consumer disclosures that are effective shopping tools. For example, we should revise the GFE so that it mirrors the HUD-1. It's one page in length, provides valuable information to the consumer, meaningful closing cost estimates, and monthly payment. Of import, any new GFE must treat the disclosures of rate, fees, costs, and points uniformly, regardless of distribution channel. Only then will we give meaning to the ability to comparison shop.

This leads me to a topic of great debate, compensation. The truth is that all originator types -- brokers, bankers, lenders, credit unions -- receive direct compensation, indirect compensation, or a combination of both. Regrettably, only mortgage brokers currently disclose both direct and indirect payments. With other originators, the back end compensation that they all earn is not disclosed. This jagged approach creates nothing but consumer confusion. Again, to make comparison shopping meaningful, all channels should provide the same disclosures.

A rule of industry. Industry must remain innovative and knowledgeable to sustain a competitive marketplace. It is competition that drives education, drives choice, and ultimately drives lower price. A competitive market tells the consumer to shop and compare. If consumers shop, then they will learn about the products and choices available to them. If consumers shop and compare, then they will have questions to ask.

But so far, much of what we hear is focused on protecting the consumer by restricting or eliminating lending practices. Let me be clear. Pricing and product does not equate to abusive lending, especially in a competitive marketplace like the one we have today.

We should refrain from any measure that seeks to use price fixing as a solution. Such a measure would do nothing more than generate anti-competitive conduct and distort the marketplace. The industry must also be vigilant to comply with state and federal laws, follow best practices, be honest, and treat consumers with respect.

Lastly, but most importantly, we cannot and should not continue to ignore the role of the consumer. We must advocate for financial literacy in this country, starting at the middle school level. This means we must allocate funds dedicated to the middle and high school financial literacy program. We must arm consumers with the knowledge and tools necessary to make informed financial decisions that fit in the context of their life circumstances.

At the same time, we must -- we must be careful not to rob this innovative and dynamic industry of the ability to remain a free and capitalist market that it has today brought affordable credit to more socio and economic classes than ever before in the history of our consumer credit system. Thank you.

MS. BRAUNSTEIN: Thank you very much. Wright?

MR. ANDREWS: Okay. Good morning. I am Wright Andrews, Washington Counsel to NHEMA, the National Home Equity Mortgage Association, which represents about 225 mortgage lenders, amounting to about 80 percent of the non-prime mortgage loan business. NHEMA's members have provided literally billions of dollars in mortgage credit helping millions of Americans, many of whom could not otherwise qualify for conventional loans, purchase homes, and meet other important financial needs. In 2005 non-prime originations exceeded 718 billion, which is about 25, 27 percent of the overall mortgage market, and about 40 percent of these loans were for home purchase.

Yes, there are some problems out there and some abuses. No question about that. But we believe that there is tremendous good done by this industry and that the vast majority of the loans are not abusive. They are fairly priced. We see foreclosures more in the three or four percent range. I'll let the economists discuss that later today, as opposed to some of the rates that others are suggesting.

We would suggest that policy makers take great care in ensuring that any legislative and regulatory changes are not in any way unnecessarily or otherwise going to have adverse effects on this important market segment. This morning I'm going to focus primarily on a few comments on the state anti-predatory lending laws.

Given the congressional failure to update HOEPA, which I think almost all sides agree is weak and does not cover an adequate range of either loans or potential abuses, it's not surprising that many states have, in fact, passed laws to try to get at some of the potential problems out there. State laws have, as I think an earlier witness indicated, generally followed the HOEPA model but have tended to add additional restrictions and I think most significantly have lowered the points and fees trigger from -- generally from eight percent to five percent and added a number of additional items, such that you have a dramatic reduction in real terms in the points and fees trigger. The practical effect of this has been to force lenders to restructure their loan pricing, and we believe that this clearly limits borrowers' financing choices and often adversely affects affordability.

In brief summary, some of the impacts of the laws or consequences are, one, lenders generally do not make high cost loans nor do secondary market purchasers buy these loans. Two, state laws actually provide far fewer protections than many people think because the only loans that generally are made are those that aren't subject to the high cost restrictions, and therefore, the protections don't apply.

Three, as I just indicated, we believe that financing choices are limited. Loans are re-priced essentially by forcing more of the upfront fees into the interest rate, and this ends up such that the price of the loan in terms of interest rate is higher, the monthly payment is higher. Bottom line, we think that most lenders can -- most borrowers will still get a loan, but they will pay higher rates.

There are many borrowers, however, who will not be able to get the loan because the higher monthly payment is such they cannot qualify under debt to income or residual income test. And they have to shift to a smaller loan, buy a smaller house, or maybe not get a loan.

Point four, the state laws do not apply to many borrowers because of the federal preemption for federal depositories. Point five, the patchwork of state laws, we believe, is uneven and has caused a lot of burden and additional costs to industry. Point six, we think that one of the best things the state laws have done is they have heightened sensitivity to these issues and many companies have adopted voluntary practices applicable to all their loans to get at this. Finally, NHEMA believes that it would be best for Congress to pass a comprehensive federal anti-predatory lending law to address these issues. Thank you.

MS. BRAUNSTEIN: Thank you very much. Okay. I'd like to ask some questions and then I'm also going to open it up to my panelists to -- fellow panelists to ask questions.

Margot, I'd like to start back with you. You were talking about the fact that in what you have seen, you don't feel that the loans are really priced according to risk, that the premiums are added on just because they can get them from the borrowers; is that correct? And I was just wondering -- But then, at the same time, you're saying that a large number of these loans go bad. So I guess I'm trying to figure -- You know, the industry might say, well, that indicates that yes, they are risky and that we are pricing according to risk. So I'm trying to kind of figure all that out. Can you talk about that a little bit?

MS. SAUNDERS: Yes. Thank you for -- I think they're priced regardless of risk, that the high price is obtained from borrowers from whom they can be obtained from and the losses that result from those loans are used as the justification for the high price. I have seen dozens and dozens of loans with very high prices made to people who had very high credit ratings. I think those people were just more vulnerable.

I've also seen many, many loans that are made to people who have run into problems. And they were -- The regional credit rating of those borrowers was indeed much lower, so there was a justification based on risk-based pricing models for charging those borrowers higher. My point is, however, that when a lender makes a loan or dozens or hundred -- dozens of -- thousands of loans, charges higher for all of those loans knowing that some great percentage of those loans will head to foreclosure, that's not good public policy to make the loans knowing that 8, 10, 12 percent of -- 12 percent of them will over the course of the following next five years end up either being required to be refinanced or forced into foreclosure.

The losses that result from a particular loan that is made to a particular borrower are made up for by the industry by the high prices charged elsewhere. And therefore, yes, you can justify making a higher -- Margot has bad credit. You can justify making a higher priced loan to Margot because you know there's a one in ten chance or whatever that Margot will default. But if you know there's a one and ten chance that Margot will default and lose her house, then don't make the loan unless you can figure out a way to avoid making a loan that will result -- has such a high chance in foreclosure. In other words, we turned risk-based pricing on its head.

MR. CHANIN: Margot, let me follow up on that because risk-based pricing -- and I don't want to debate, you know, kind of what goes into different pricing schemes. But clearly, some consumers pay more for mortgage loans and other financial products than other consumers. Sometimes that correlates fairly highly with credit score or other factors.

But the dilemma is -- Let's just take your example of a ten percent default rate, which would be a pretty high default rate or foreclosure rate. That means that if you made a hundred loans, ten of those are in default or foreclosure, but 90 of those loans are not. And what we, you know, have to balance is the notion of expanding opportunities to people who might not otherwise qualify for credit.

That is, you know, 10 or 20 years ago there was a great push to try and make credit available to more low and moderate income individuals, and we want to make sure that in structuring any guidance or regulatory changes and the like that we don't constrict that marketplace. And in your example, that might mean not making loans to 90 consumers who don't go into default and foreclosure. So how do we avoid that dilemma? And that -- You know, that would, I think, be unfortunate from all points of view.

MS. SAUNDERS: Well, Leonard, as you know, the National Consumer Law Center works with Legal Aid offices and pro bono attorneys and private attorneys all over the country, and what I'm trying to tell you today is we want to constrict the marketplace. We are not doing our clients and the low income homeowners across the country any good by retaining access to credit, which is poison to them. We're not talking about home ownership. We're talking about loss of home ownership.

The whole market has changed. We are -- It is now, as Bill was describing, a push market. And I think Ms. Kent was describing, a push market where there are more loans to be made than borrowers need to have made to them. I have on my desk today -- I'm doing an expert report I'm finishing up -- of a prototypical borrower that should never have received a mortgage loan. A low income homeowner -- actually, not a low income, $60,000 a year, family of four, they went into a mortgage broker, had a low cost 7 percent, $70,000 home loan, 27 years left on the home loan. They had $5,000 worth of credit card debt.

They went to a mortgage who promised, come, we'll help you. Mortgage broker said, sure, we'll help them. They refinanced $5,000 worth of credit card debt, $11,000 worth of car loans, gave them $8,000 to pay off some relatives, ended up with $120,000 loan on a house worth $75,000. The payments are $40 less a month. The home equity is now in the negative numbers and will be in the negative numbers for the next 15 years. Now, that is a mortgage loan that didn't need to be made, and that is typical. They save $35 a month and lost $40,000 worth of home equity.

They're paying -- Just take the car loan. When you refinance a car loan that has three years left to be paid into a 30-year loan, you're paying $11,000 extra in interest over the next -- for an extra 27 years. These are not good loans. You need to restrict the marketplace.

MS. BRAUNSTEIN: And we're going to get back to those issues. I just want to -- Barbara, I'd like to follow up with you on a question. You made a statement that, in general, even the state statute that you enacted in New York has had very little impact, that it has limited impact, that because of the low rates. So I just wanted to follow up with you. What would you recommend if your statute didn't work? What would you recommend at this point that you would do going forward like in New York?

MS. KENT: Well, first of all, I guess I want to clarify that as interest rates are starting to go up, the statute may become more relevant. But so far, it's primary purpose has been to keep loans right below the threshold. I think we need to take a different approach than a threshold-oriented approach.

I don't think it's a disclosure approach. I, for one, don't think that disclosures work. I think it's going to have to be a substantive approach where some things are allowed and some things aren't allowed.

And the -- I mean, the easy answer is to say that we would just lower the thresholds, but I don't think that

that is a suitable answer. I think we have to ban certain practices in any loan, even if it's priced at 3 percent -- fixed rate 3 percent, it just shouldn't have certain provisions. And we can discuss, argue what those provisions should be, but I think they should just be illegal in any loan.

MS. BRAUNSTEIN: Do you want to give a couple examples?

MS. KENT: Sure. I think no matter what the loan is, it has to be underwritten for affordability. And with the new non-traditional mortgage products, I think it has to be underwritten for affordability when the increase comes, not just affordability now at the so-called introductory rate.

MS. BRAUNSTEIN: And do you define affordability as showing ability to repay?

MS. KENT: Yes. Well, showing ability to repay and we -- but that can be a very vague standard. I would use the two -- I would use the two tests in the New York statute, which are 50 percent of gross month -- your mortgage payment cannot exceed 50 percent of your monthly gross income -- excuse me -- and it cannot exceed your discretionary -- your leftover money cannot exceed the VA guidelines.

The Veterans Administration has published residual income guidelines, and they're really quite low. If you don't have that much money leftover after you've made your monthly mortgage payment, you will -- something -- you'll either not be eating or paying your other bills or you will be going into foreclosure because they are calculated by family size and by geography. And they're, as I say, on the low side.

So I would say the major one has to be affordability and affordability when the increase is going to come, and that affordability should be for everybody's income, or you could have a very high limit cut off. I mean, there does come a number where affordability may not be -- it may not be an issue.

MS. BRAUNSTEIN: Thank you.

MR. MICHAELS: Let me just ask a follow-up question on that because a number of years ago when we talked about -- when were having HOEPA hearings and we talked about affordability tests and we talked about whether a particular percentage test for debt to income ratio would work, one of the concerns, I think, was expressed was if you had a numerical test whether or not there would be a presumption that falling just below that number made it automatically affordable, and I guess there was some reluctance by people to sign on to a strict numerical test, which would create a presumption of affordability if the test was met. Does your law deal with that?

MS. KENT: Yeah. It specifically does not create a presumption of affordability. There is no safe harbor, if that's what you're asking me. And I think that the -- I think a lender would be very safe in New York. I mean, there is no specific safe harbor, and it doesn't create a presumption, but I think if there was less than 50 percent and it met the VA residual guidelines, I think practically speaking as a regulator there would be nothing we could do. What more could we have asked of the lender, assuming -- I guess I'll put in one other caveat. If it's one of these non-traditional products that they had done that for the -- for when the income is -- when the mortgage payment is going to go up. I don't know what else a lender could do.

MS. BRAUNSTEIN: Bill, I wanted to ask you about some of the things that you talked about that you've seen in loans that have come to you are basically fraudulent practices, like people misstating incomes, you know, having bad information in paperwork, and things like that. And aren't there already adequate laws to protect those kinds of things? Aren't there legal means to --

MR. BRENNAN: We have state licensing agencies. For example, Georgia has the Department of Banking and Finance. The people who work there are good people. They are well intentioned, but I can tell you right now I wouldn't dream of sending a case over to these people for some sort of enforcement or even criminal enforcement because nothing happens. You know, our sense is that we can't take this case to a district attorney. They tell us that they're too involved in violent crime, rape, and murder.

The answer is no, we don't have any resources that are available to address that aspect of what we're seeing. And I must say, we're seeing it in the majority of the cases that walk in the door. We have a UDAP law in Georgia, which is not very effective. It doesn't help us there. And so, just to give you the answer, I mean, I wish I could pick up the phone and call somebody to say, look, we're finding falsified applications, falsified income, and they'll do something about it. But that's not what's happening.

I had a lady who lost her job at a credit union because she had applied for a mortgage loan to buy a house. When she didn't get it because of a delay, she went to another mortgage company and did a get a loan and bought a house. It was a house I thought she couldn't afford, by the way. But in any event, there was a falsified application on the first loan, and it got to a company in Chicago that called her employer at the credit union and said she lied on her application, and she lost her job. She was threatened with the loss of the job.

Now, I did go to the Banking Commission with that case, and they did step in. They took the license away from the broker in that case, but that's the only case I've ever gotten any kind of relief from. If I approach them with what we're seeing every day, I don't think we would get much help.

MS. BRAUNSTEIN: Okay. Thank you. Gail, you mentioned that of all the states with laws that you -- you used the number there were only seven that had effective laws. And I was wondering which ones those were and what is it that makes those laws effective.

MS. BURKS: The laws -- The states with effective laws are North Carolina, New Jersey, Massachusetts, Ohio just passed one, New Mexico. What makes those laws good is the fact that, one, they address different practices that specifically go to, for example, how much consumers are charged. They give consumers a cause of action, a way out. New York has a good law, as well.

Three, they look at specifically practices, some of them, of brokers. Four, they have a good definition of points and fees. None of them get to yield spread premiums paid by the lender, specifically. And the biggest part is they have enforcement. Private rights of action for consumers, that's what makes them a good law.

Some of the bad laws, what makes them bad is they are too restrictive. They only apply to HOEPA, and HOEPA is not where we're seeing most of the action today in terms of predatory lending. That's what makes a bad law.

MS. BRAUNSTEIN: Okay. Thank you very much. Harry, you talked about some of the recommended practices that your organization has, you know, put forward. And I know we've heard this in other hearings, too, about saying that people can't tell the difference between a broker and a lender, and that for that reason everybody should have criminal background checks and licensing and things like that. And I just wondered, one of the things that seems to me that may differentiate, though, is that if a lender's working in a financial institution, don't the financial institutions generally as part of their hiring process and due diligence do the criminal background checks, and whereas, you've got brokers out there running around and nobody's checking up on them?

MR. DINHAM: Some of your depository institutions do do background checks at that point. I think mainly the officers of the banks, our main concern is the -- is the educational requirements and the licensing of those people so we're all under one standard at this point. I think the consumer is really being done a disservice because it's assumed just because they're a depository institution that they know all about mortgage lending at that point. And we think there needs to be pre-hiring education and continuing education for those people also.

MS. BRAUNSTEIN: Okay. Thank you. Wright, I have a question. At the end of your statement in terms of your recommendations, you said that there should be a federal predatory lending law. I was wondering in your mind or for your organization, what do you think that should include?

MR. ANDREWS: Well, again, as I think you're aware, there have been various proposals in Congress and, you know, I think we will see more. But I think basically you need a broad federal standard that provides effective protections. Now, to do that, you -- I personally think, and NHEMA has taken no position on this, but I personally think that you are almost certainly going to have to go to covering more than is covered under the current threshold approach. I think as Barbara's suggesting, there are -- if the practice is abusive, it should be prohibited.

I think you will have to look toward having things, such as a borrower benefit test, clearly a stronger repayment ability test, one that will probably deal with both a DTI type test and residual income. I think in that you are likely and should see something to clarify the debate that has occurred with respect to stated income loans, how far that should be.

There will obviously have to be some congressional evaluation of how far one should go on the assignee liability issue. Now, Margot and a number of the advocates want full assignee liability. Industry generally takes the opposite approach, but I think there may be some limited assignee liability that is workable. The big concern there remains that industry could find itself without adequate sources of low cost funding, which means you can't make the loans to folks, etc.

Those are some of the things. One of the big issues obviously that is talked about, it's been mentioned here today, and again this is one that industry does not have a position on yet, but is the suitability issue. That is the mantra of the advocates we hear around the country, as well as in Washington. I think the issue there is going to be how you would define something. You know, do you have fiduciary responsibility? No, I don't think so. But maybe there is something in between. I think these issues that will have to be worked out and looked at. But I think we're moving beyond the traditional HOEPA very clearly in my opinion.

MS. BRAUNSTEIN: I would like to spend a few minutes on suitability because I think that's a really important issue. And it's come up, not just here, but in every hearing that we've done, that has been a huge issue. And so I would like to hear some of the different views of the industry and the consumer groups on what would be contained in a suitability standard, how would that work. And also, at some point, Barbara, I'd like to hear your comments because when -- if you have feelings about that because that's not something you mentioned in relation to the New York law in terms of local law. But I don't know who wants to start, but I'd like to hear some discussion. I don't know. Margot or Bill, you both raised suitability standards in your comments and how would you see that working and how would that be --

MS. SAUNDERS: Would you like me to start?

MS. BRAUNSTEIN: Whichever, that's fine.

MS. SAUNDERS: We have worked within the structure of HOEPA for years and with the various tests like net tangible benefit that have come up through -- with the states and tried for many years to construct clear language that would guide the industry on what are good loans and what are bad loans. And we find that there is no clear rule that you can -- that we can come up with, that our best minds -- and we have some very good minds around the country -- can come up with that would truly stop the bad loans from being made.

So what we've done instead is decided we need a vague standard. We need a deliberately vague standard that we could -- I've been calling it the grandmother standard.

If you wouldn't make the loan to your grandmother, maybe you shouldn't make the loan. But the idea is to get the lender, the originator, to --

MS. BRAUNSTEIN: Of course, that would depend on who the lender is and how they feel about their grandmother.

MS. SAUNDERS: I understand. But the point is deliberately to create a sense of danger about making a loan that may go bad so that the originator has to justify why this loan is a good thing, why the risks are appropriate, why the borrower truly understands and still wants to accept this loan. In other words, we get away from the automated underwriting for bad loans which we have right now with so much of subprime lending.

I'm sitting here looking at Option One's AB report that appeared online. And in 2000 -- The 1999 loan pool has a one in eight foreclosure -- one in eight of those loans has been foreclosed upon. We want to make every loan that Option One makes and all the other big subprime lenders, have the people that make the loans and the people that buy the loans concerned with whether or not they were the right loans to be made. And if -- I have a --

MS. BRAUNSTEIN: And I've also heard in other hearings people describe the suitability standard as working not just is this the right loan for you, but if we have 12 other products, making sure that which -- that there would be some responsibility to make sure out of those 12 you give them the best one of the 12 for their circumstances. Is that also what you --

MS. SAUNDERS: Yes. You look at does this consumer need a mortgage loan and what mortgage loan product do we have available is appropriate for them. The -- What is the costs of this loan, what are reasonable costs, can this borrower repay the loan, is the cost -- short term and long term equity costs of this loan appropriate in exchange for the benefits for refinancing, for taking money out, for avoiding foreclosure. These are evaluations that investment counselors make every day when they take our money and put them into the securities market.

And yet, comparatively, that's a much less risky transaction than taking a mortgage on your home loan because you're not only dealing with your current savings, you're dealing -- in a home loan, you're delaying with future savings and future income. It's a much more complex transaction, and the distinction between how much the homeowner knows and how much the lender knows as compared to how much the investor knows and how much the investment counselor knows is much greater. The ratio between knowledge is much greater. So if we had suitability --

MS. BRAUNSTEIN: And one of the things -- It's an interesting discussion, and we don't have a position at this point on this, the Fed. But I will say that historically the way we have operated has been to require the lenders to disclose information. But the -- Frankly, the decision has laid with the consumer -- has remained with the consumer to evaluate the disclosed information and make decisions as to what is the best product for them as opposed to putting that on the lender to make that decision as to what the best product is for the consumer.

MS. SAUNDERS: Well, that may work in the prime market. It probably does work in the prime market, although I get a lot of calls from fairly sophisticated people who don't understand their loans and made bad decisions. But it doesn't have as devastating consequences in the prime market.

It clearly does not work in the subprime market. What more evidence do we need that we need substantive regulation than the escalation of foreclosures and the huge loss in the Fed's own statistics of home equity. It's not working.

MS. BRAUNSTEIN: Barbara, I'd be interested from -- Do you have the perspective on this as a regulator and you didn't use the suitability route in New York, so would --

MS. KENT: The -- It's interesting because when we were drafting the regulation back in 1999 and 2000 we gave consideration to doing away with it and just doing a suitability test. We backed off of that because of a banking department sort of has a slightly different role in this. We go out and examine loans. What were we going to tell our examiners they should be looking for? You can't tell them the grandmother standard. They have to have more specific guidelines than that. So we tried to create, without using the word suitability, a suitability test with affordability, with refinancing time limits, with yield spread premiums being included, with -- that you can't finance high cost -- I'm sorry, that you can't finance single premium credit insurance and yield spread premiums are included in the points and fees.

So we tried to take the elements, but it does leave out the fact of the products that you mentioned. They have a dozen products the lender has the responsibility to steer the consumer to the product that's best for them. We would need more -- We would need substance to a suitability test. We don't have any objection.

We wanted to go that way to begin with and -- and think it could cure a lot of problems. But for us, it creates the problem of what -- of how do we examine for it and how do we take someone's license away if we don't have some specific standards for it, how do we bring an enforcement action.

MS. SAUNDERS: Yeah.

MS. BURKS: On this point I am speaking for Nevada Fair Housing Center alone, and CRC has not taken a position on suitability. As an agency that advocates for choice in housing and lending, I think we have to be careful about telling a consumer in the issue of getting the loan that has a benefit what is sort of good for you. The difference in the investment world and the mortgage world is that as an investor, if you are investing my money, I have a different bargaining position. I have more power than I do in the lending arena.

So if by suitability we are talking about a final decision by the lender as to what is best for the consumer, I think we have to be very careful and tread lightly. I think we can get there by looking at practices, regulating bad practices, and looking at a benefit versus sort of going that extra step.

MS. BRAUNSTEIN: Either Harry or Wright, you want to comment?

MR. ANDREWS: Go ahead, Harry.

MR. DINHAM: Well, I have to agree with what Barbara said. The problem with vague is it always ends up in the court system, eventually, you know. We're for -- You know, we would be for some type of suitability if you can define what it is so everybody on both sides knows exactly what we're talking about at that point. When you talk about a grandmother like they said, you know, I don't know whether you like your grandmother or not at that point.

But I really believe that this is something that's going to come along, a suitability, affordability in some manner. I can only relate it back to years ago, FHA used to have a scoring system of six different things -- six different -- I don't remember what the categories were, but there were six different categories which you had to score 90 or above in in order to be able to get that loan through FHA. So it's been done in the past, and they look at more than just income and credit and that sort of thing. So I think going down this path of trying to find something industry related that works for both the investment side and for the regulation side would be good.

MS. BUCHANAN: Excuse me. I would like to chime in, if I could.

MR. ANDREWS: Okay.

MS. BUCHANAN: Oh, please go ahead and I'll --

MR. ANDREWS: Okay. Again, certainly affordability and a benefit test, if that's -- which many people would consider part of suitability, I don't think industry has great problem with that. I think there is concern, though, in the other area of how do you decide what is best for someone. There are so many products out there and so many factors go in, they are subjective decisions, personal decisions to be made. I really don't know how you could deal with some of those issues. The vagueness is incredibly vague. Industry's very concerned that that could lead to a tremendous amount of unnecessary litigation.

Also, just to comment, I think there is a difference between a stockbroker working with you and a lender or broker. Certainly lenders are not representing the borrower, and I guess most of the time, Harry, they are not representing either the lender or the borrower. You know, there has to be information provided, disclosure provided. But there has to be some responsibility on the borrower's part to make some decisions.

And I think in many cases you've got a broad range of products. Any of them might work, but you could also allege that anyone you put them into if the loan goes bad, oh, that was wrong, guess what. So again, great care has to be taken as these are explored.

MS. SAUNDERS: Let me give a few specifics. I think I may have not been clear. I think we can easily provide the questions that should be asked that would go to the evaluation of whether a loan is suitable. It's the clear answers as to those questions that make it more complicated. Many of these things have already come up. The ability to repay should always be a critical part and that ability to repay should be based on both -- as Barbara said, both a percentage and residual income. Residual income is critical.

Two, you look at the cost of the loan, and the cost of the loan is evaluated in three ways. One, the points and fees that are stripped out of equity right now. Two, the payments. And three, how long is the term going to last. In other words, how long are these payments to be made.

You compare those costs of the loan to what the consumer is paying now. And you look at -- And the next question is, what is refinanced. It's -- No, we're not saying a lender has to say to a borrower, no, we're not going to refinance $5,000 worth of credit card debt into a 30-year loan. But if the borrower walks into the lender and says, I need refinancing $5,000 worth of credit card debt, there's got to be a good justification for refinancing the whole first mortgage and all this other debt, in addition.

In other words, a loan that smells has to be explained and justified, and it may be still appropriate. Then you look at what the product is. A fixed rate, low point and fee, low interest rate loan doesn't have to be justified if it's at 20 percent of debt to income. That's clear. But when you make a option ARM, which is going to explode in three years, to someone who can only afford it this year to a fixed income Social Security recipient, that -- you know, I would say as the lender you've got to explain now really well on your books why that loan is suitable or not unsuitable. So we can give you the questions but -- and we're not saying the loan shouldn't be made, just that they need to be justified.

MS. BRAUNSTEIN: Bill, you said you wanted to say something, and then Joan --

MS. BUCHANAN: I'll follow up.

MR. BRENNAN: We're certainly looking at the issue of suitability versus underwriting standards. And actually, we see it a couple of different ways where suitability applies in real life cases. I actually have a live client here, Ms. Elizabeth Giles. Would you raise your hand, Ms. Giles? She's sitting in the back there. Just to tell you where -- Thanks for coming.

Ms. Giles is my client, and she is 78. And she has 1088 a month income, and she got a loan from a prominent subprime mortgage lender for $118,719. And her monthly payments were 826 a month, and it was an ARM not pegged to an index. It just went up, up, up. And she pays principal and interest only, no escrowing for taxes and insurance.

So that's an underwriting issue for us. But let's talk about suitability for a moment. We think that in Ms. Giles' case and in many, many of our other senior cases, she should have been examined or looked at for a reverse mortgage. And there's a suitability issue. That's another loan product that for the money that she thought she needed to get this loan that would have been perfect for her. And she would have been eligible either on this loan or the last subprime loan she had in the chain of subprime loans that were push marketed on her.

And so there's a suitability issue, I think, which needs to be looked at. Another suitability issue is doing a -- an ARM to someone living on fixed income. You may be able to afford it today, but they won't be able to afford it down the road. So for underwriting, they're okay now. But down the road when the interest is going up, they won't be able to afford it. I think that tends towards suitability.

So I think there are some clear cases where you can identify suitability issues and, of course, I agree with Margot about keeping it vague because you need to. But it's an issue for us and it ought to be on the table: suitability standards.

MS. BRAUNSTEIN: Joan?

MS. BUCHANAN: I wanted to follow-up with the panelists, kind of in line with suitability, is also our ability to detect these issues. Being an examiner, I kind of follow the same train of thought that Barbara does often. And one of my big struggles is the mismatch between what we're hearing from the consumer protection folks on the panel and what we find in our examinations. And we do very robust examinations for high cost mortgages and HOEPA.

Our examiners routinely pull foreclosed single family files to go through those to look for any troubling issues. They look at those often for suitability, as well -- general suitability and prudent underwriting standards, debt to income, loan to value, things like that.

We do not find the problems, especially at the level that you're discussing these. And I struggle with what the mismatch is between the detection and what you all are seeing. Can you comment on, perhaps, you know, a void there?

MS. SAUNDERS: Are you just looking -- What do you look at?

MS. BUCHANAN: Mortgage loans.

MS. SAUNDERS: But what documentation do you look at?

MS. BUCHANAN: All of them, the entire file. We look at them for fair lending. We look at them for -- you know, the safety and soundness folks look at it for underwriting. But like for example, one of the things I struggle with is the example you posed of a loan that was 130,000 and the home was only worth 70. That's like a -- almost a 200 percent loan to value. That is something we never see.

MS. SAUNDERS: But no, the appraisal came in -- The home was bought in 1999 for 75,000. The appraisal came in at 120,000. But you look closely at the appraisal itself, at the appraised form, and you can find the ways that the appraiser cheated. And it's appraisal fraud.

MS. BUCHANAN: Okay. So, that's appraisal fraud issue.

MS. SAUNDERS: And we see appraisal fraud problems all along.

MS. BUCHANAN: Okay.

MS. SAUNDERS: It takes hours to figure out, you know, on the face of it, this appraisal looks fine. It looks just like every other appraisal, but you examine and what's the problems. Well, there's no justification provided for it. How did a house in Beckley, West Virginia, increase from 75,000 to 120,000 in one year? That's a Fannie Mae, Freddie Mac, FIRREA, USMP, every appraiser standard on the books requires that justification to be provided. The underwriter, a big bank, didn't find that.

MS. BUCHANAN: Okay.

MS. SAUNDERS: So you're -- I don't know that you're looking at the same things I'm looking at.

MS. BUCHANAN: And on Bill's example, this unfortunate instance with like an 80 plus debt to income ratio, that's --

MR. BRENNAN: The income -- See, here's the answer to that. We look at loan files all the time. We look at the same loan files that assignee ends up in their portfolio, and it looks great. I mean, here's somebody with 1,000 a month income, but it says on the application that their income is $4,600 a month, that they have two jobs. They're working as a dispatcher at a trucking company. I always remember that one. And they're not. They don't know anything about it.

The point is that for underwriting, there's no decent, honest effort on the part of the lenders to verify income with documentation that can be meaningful like they used to do. Gosh, when I got a mortgage in 1983 to buy a house, I had to go through so many hoops to qualify to get that house. There had to be a letter from my employer that went not through me but directly to the lender and so forth, which was a savings and loan.

But we don't have that anymore. There's no underwriting going on. I mean, it's a joke. They just put down whatever it takes to make the loan work to go into the securitized pools. And so, when we call and raise an issue on it, they pull out the file and say, what's wrong with this loan. It looks perfectly fine to us, and it's because there's no underwriting going on at the front end.

MS. SAUNDERS: Application fraud, right.

MS. BUCHANAN: So that income, though, there's no verified documentation in the file which is --

MS. SAUNDERS: Oh, that I see all the time. I see letters, Social Security Administration, this is to verify that you have $1,000 a month Social Security income, but then you -- then you ask, well, is this true. No, I don't get that much. I get 600.

And what we find cut and paste jobs. That's what they're great at, cut and paste. So they take a letter from the Social Security Administration. They type up a new letter for the body and they cut and paste and Xerox it and make it look like the real thing.

The problem is the industry -- the investment -- investors don't suffer. When Bill's client goes to foreclosure, there's enough equity in that house so that it won't go to foreclosure. It'll go to forced refinancing so that the risk will get pushed on to the next lender.

And we're bleeding equity and bleeding equity, so that homeowner may not even appear on the statistics as a loss to this borrower. And you -- Four or five loans later, that homeowner will go to foreclosure, and the last lender will actually let it appear as a loss, which justifies the high ratio.

MS. BUCHANAN: So if you're looking at

suitability, you may pick up the file, and the file certainly looks suitable, whether you have specific or general guidelines regarding the suitability. The issue is the fraudulent aspect of those.

MR. BRENNAN: I would almost suggest, call the homeowner and start talking to them. That's where you find out what's really going on.

MS. SAUNDERS: Occasionally you need to do that.

MR. BRENNAN: I mean, that's what we do. We just sit there and start asking questions. My associate, Karen Brown, is going to bring somebody up in the open mike this afternoon, one of our clients. She got the whole file from the lender. And I don't want to steal your thunder here, but it said in there -- the lender said to the originator, get the Social Security letter but black out the income that she's getting. So it was obvious that they want -- And they did. It was obvious that they wanted to show that she had income but blacked out the income so that that would get it through into the securitized pool. Pretty amazing.

MS. BURKE: May I -- May I make a point on the examination issue? She said that you're not discovering the files. I think it may also be the question of the time difference between when you examine and when the issue occurs. You don't examine every year the same lenders. And so, therefore, some of these issues you may not pick up.

It also depends on what's been sold, whether the whole servicing has been sold on the loan or the part of it's been sold. So there are gaps that you may not pick up. And maybe one thing we could do in regulation is to have you sort of request those documents about those issues from consumers more along that line when you do the examination.

MS. BRAUNSTEIN: I think another issue with that, frankly, is that we probably don't see as much of this with -- We're only examining state member banks, and we're not seeing it there as much. We're not examining a lot of the entities where this stuff is more likely to happen, so. Can we --

MS. SAUNDERS: Can we examine --

MS. BRAUNSTEIN: I want to turn over to Leonard, Jim. Did you have questions?

MR. CHANIN: Yeah. Let me move to -- Bill, you and Margot, a question. Bill, you'd mentioned that you've seen an increase in foreclosures for these transactions and others have mentioned abusive practices, for example, where income is stated that's insufficient, the debt to income ratio, and so forth. Generally and I assume the answer's anecdotal, but can you give me a sense on whether the biggest problems are in the refinancing market or the home purchase market? And if so, are we talking about the problems are generally 90 percent are in refinancing or 90 percent home purchase or how does it split, recognizing -- I assume it's anecdotal, but it would be helpful to give me a sense of where the biggest problems are among those two markets.

MS. SAUNDERS: I would say -- and Bill may say -- I would say from our folks around the country, it's well over 90 percent refinancing, that almost all these problems are refinancing. That's not to say that we don't need some protection in the purchase money market, but the abuses that I'm talking about today are refinancing.

MR. BRENNAN: I agree with that. We do occasionally see the home purchase cases with falsified statements of income and so forth, but the biggest volume of cases we're seeing is in the refinancing area.

MR. CHANIN: Okay. And in a, I think, somewhat related question, you had mentioned, Bill, that you're seeing an increase in loans where consumers don't have the ability to repay, that is, the consumers can't afford these loans. And depending on what factors you're looking at, that can be translated into lots of different factors. And I just want to get a sense of, if you can, specifically what are the biggest issues?

For example, one has already been mentioned is there may be falsified income. So for example, it may be the consumer's debt to income ratio is perfectly fine on paper, but the income is stated at, let's say, $40,000 a year when, in fact, it's 20,000. So that's one issue.

The second, though, may be that the debt to income ratio is, in itself, too high, that is, as the example you gave, something like 80 percent, I think, debt to income ratio. Or there may be other issues in terms of consumer's inability to pay. It could be you're looking at, for example, as a third example that today the consumer can repay, but in two years if rates go up, then the consumer gets into trouble because rates have bumped up, let's say, two percent, and then the consumer can't repay the loan.

So again, kind of overall, is there one most significant problem that you see and maybe something I haven't mentioned in terms of consumer's ability to repay or is it quite mixed?

MR. BRENNAN: I would just -- Barbara can speak to this, too. But you know, the funny thing is what we're seeing is just almost immediately that the -- there's no way in the world the borrower could afford this loan. It's not some subtle difference between one issue of debt to income ratio. I mean, we ask that question right off.

I mean, I usually ask a simple question just to get right to the point, which is, what's your annual income? You know, it's $21,000. And what was the amount of your loan? 140. We have sort of a rule of thumb, you shouldn't be on another -- It's not debt to income, you shouldn't be borrowing more than two to three times your gross annual income, assuming you have little or no debt. That's where we start.

Sometimes we get into the debt to income analysis but not often because what we're seeing so much of is there's no way they could afford this loan. And the reaction anecdotally that we're having every day is, there must not be enough eligible borrowers out there to get these loans. They're pushing these people into the loans, I think, to fill the pools wherever they can get them. You know, they're a warm body. They're lining them up and putting them into the pools. And that's what's happening.

MS. KENT: Can I just add a point to that?

MR. CHANIN: Sure.

MS. KENT: I think that suitability is important, but one of the other ways that suitability becomes important is through compensation. When -- When the lenders' employees are compensated largely on the number of loans that they make, they will find a way to make the loan. It may be appraisal fraud. It may be cut and paste the Social Security statement. It may be a letter written on yellow paper saying that I make $3,000 a month in addition through babysitting income. It'll be whatever it takes to get that loan over the hump.

And that is -- That's how you get -- Everybody has a different anecdote of how it happened. And what -- Because they'll do anything to make the loan, and I don't know that you can directly attack that through compensation or sales practices, but that's another reason why suitability is important and why affordability is important as part of suitability. Because as much as they'll want to make the loan if there's some substantive guideline that they can't do, then they'll -- it'll act as a break.

MS. SAUNDERS: The practice of grossing up is grossly mismanaged. We see Social Security income, $700 a month, grossed up by 130 percent. Nobody that lives on $700 a month is paying 30 percent federal income tax so that they -- the -- although this is not -- this practice is not illegal under any guidelines or even improper under Fannie or Freddie guidelines, it misses the point. And it's completely -- It's totally irrelevant.

If you have a residual income guideline like New York has, it protects against a lot. And the VA guidelines are really quite good. And New York's -- If New York's guidelines applied to all loans in New York, instead of just the high cost loans, we wouldn't be seeing these recent foreclosures.

The problem with the state laws is all of the good protections just apply to the high cost loans so that the high cost loan triggers in the states work as usury caps, which are better than nothing, which means the -- in these states the cost of the loans have gone down. But we need these rules that apply to high cost loans to apply across the board.

MR. ANDREWS: Can I just comment briefly? Again, you know, as I said at the opening of my testimony, certainly there are problems out there, and there are more problems than we would like. But I tend to think that, Margot, you and many of the advocates like Bill who work on the front lines, see many of the very worst cases, and there are some undoubtedly bad, bad cases out there.

That said, we don't think from an industry perspective that the problem is nearly at the extent you're suggesting. We don't think that foreclosures are that high. Again, I'll leave that for people like Doug Duncan of the MBA and people who can give some foreclosure numbers, but we don't see that it's that high. Lenders are not making money from foreclosures. And appraisal fraud, yes. That is -- I'm hearing an awful lot here about appraisal fraud. Huge problem.

Lenders are doing a tremendous amount today because they -- it is hurting them very badly. It's hurting the customers and the lenders. So you know, we have -- We're sort of talking about two different worlds here, and we would continue to maintain that the overwhelming majority of the non-prime loans are not subject to all of these. But you do have these problem areas.

MS. SAUNDERS: With all due respect, Wright, what drives us, what brings us to this table are not just the cases that we have on our desks, it's the escalating foreclosure numbers in counties across the country. It's what made one of the most conservative legislatures in the country, Ohio, just pass a fairly strong predatory lending law.

And I'm not looking at a advocate's statistics here. I'm looking at the statistics from the company itself that will post it on the Web as required by the Securities and Exchange Commission. And it says in 1999 -- of the 1999 loans that were made by Option One, subprime loans, 12 percent of them have been liquidated in foreclosure. That means -- These are not --

MR. ANDREWS: Is that --

MS. SAUNDERS: -- my numbers.

MR. ANDREWS: Is that referencing the loans that are still on the books? It probably is only referencing that small number that's still on the books. Again, I think you will find the numbers are more realistically three and a half, four percent.

MS. SAUNDERS: What we're seeing in our offices, and we would like -- the legal services offices would love to stop spending resources on consumer law and spend them instead on -- on employment issues and health issues and other issues that are also need sufficient attention. We have turned it to consumer law because of this escalating problem.

This is not a problem that is our creation. It's -- You look across the country, look at the raw statistics in Chicago, in Ohio, in Georgia, in North Carolina. Foreclosures are going up, just raw numbers. Too many loans are being made that will end up in foreclosures.

MR. ANDREWS: Well, again, in some pockets there's no question you have foreclosure problems. Again, some of those pockets, I think you will find not only issues such as the economy but some real property flipping and fraudulent type practices. But again, I'll leave that to others to talk. Bill?

MR. BRENNAN: Wright, I would just respond also by saying that I tend to see a lot and we do see a lot. And through the years Karen Brown and I have looked at hundreds and hundreds of loan pages, documents and we've -- I think we've looked at every major subprime lender in the country. And I'm telling you, lending without regard to the ability to pay is occurring with every subprime lender. I know we don't want to get into naming names. Just name the name.

I've seen it: Countrywide, Option One, you name it, Wells Fargo. We're seeing that going on across the board with every single subprime company.

So when you say there's some bad actors out there and that's too bad, I tell you the bad actors are in every major subprime lending company. Lots of them because this is what we're seeing, and that's what's going on. And I know what -- I think why they're doing it. They need to fill those pools up because there's no risk at the investor side of this equation.

All the risk is placed on the homeowner. They can mix and match the pools in a way with loans with the certain number of bad ones being put in that aren't going to hurt the investors who the securities. And there's no full assignee liability like there needs to be. If there were, this would stop.

If there were laws making these types of practices illegal with full assignee liability along the lines of the FTC holder rule, which has worked very well in this country, this stuff would stop. So I just really must disagree strongly when I hear people say there are bad actors and it's a shame this is going on. But in general, the subprime industry -- Let me say one more thing.

Here's a subjective opinion. I would never allow any of my clients to go out and get a subprime loan because

I know they will be ripped off. I know they'll get a loan they can't afford. If Ms. Giles called me and said, Mr. Brennan, I need some money -- and I get those calls -- do you think I should go out and get a loan from Option One or one of those. Heavens no. Don't go near them. Get a reverse mortgage or don't get a loan. That's the way we view these, and we've been working on -- I've been doing this for 18 years looking at these loans. And that's the reality of what's going on.

MS. BRAUNSTEIN: Jim, do you want to --

MR. MICHAELS: Yeah. And we're running out of time here, so let me try to throw this question out quickly and let you react. I guess the question I have is we've spent a lot of time talking about suitability standards and Margot led off the discussion by talking about how they need to be deliberately vague. And I just want to throw out the question of how would that likely play out in the secondary market. How would the secondary market deal with suitability standards that were less than precise? I don't want to use the term deliberately vague. That's Margot's. She's coined it. But how would the secondary market and the bond rating market, in particularly, deal with those kind of standards?

MS. SAUNDERS: Jim, can I -- I have to go. Can I just take a one minute? The FTC in the 1970s passed a rule that required that all buyers of car loans and other loans used to purchase goods were fully liable up to the amount of the loan for -- for all claims. And at the time the FTC passed this, the industry screamed, you're going to cut off credit for cars, you're going to cut off credit for furniture loans, and so on. And that was not the case.

It's a uniform national standard that's implemented uniformly across the country, and there was not even a blip in the market. So that's what we're proposing, apply the same in the mortgage market. It's not a state by state where the secondary market can say, well, we're not going to give a crap, we're not going to do loans in Georgia anymore because we can still make money in the other 49 states. If it's applied nationwide, we think it would have the same affect as the FTC holder rule, which is none. They would learn to adopt -- adapt.

MR. ANDREWS: I think you'd get a different perspective from industry. Again, I think the two big results would be, obviously, many of the secondary market people would be very concerned and would be less willing to lend. We've heard that repeatedly from the Bond Market Association and others in testimony in Washington, certainly. The other thing, obviously, to the extent they lend, they often would be lending at a higher cost, which ultimately means higher cost to the borrowers.

MR. DINHAM: And I just want to respond, too. Any uncertainty seems to concern the bond market and the investors. I'd give an example of Texas. When Texas passed their home equity law, which has several restrictions, it was -- in other words, you could get a -- you could readily get a second lien home equity loan, but you could not get your first lien or a refinance of your total deal. There were only three investors that would come into the state until some of the unknowns were fixed out -- were settled.

So I would say that it's going to have a negative effect as far as credit availability if you -- if it's uncertain to the market at this point. If they don't know what the problem is, they're going to have a problem lending money to it, so.

MR. ANDREWS: My memory suggest that you had that very problem here in Georgia originally with the Georgia law. One of the big concerns was assignee liability that literally shut down part of the market for a while.

MR. BRENNAN: And let me address that. Standard and Poor's did an analysis of the Georgia Fair Lending Act, which contained complete falsehoods. And my suspicion was that Standard and Poor's was brought -- Because they profit from rating subprime securities. They were brought into Georgia to make false statements about what that law contained.

And the argument was made, we're going to shut down all mortgage lending in Georgia because these loans cannot be securitized because Standard and Poor's wouldn't rate them. In Standard and Poor's press release, which we responded to, indicated that they completely misstated what the law provided. For example, there was now assignee liability for all loans under the act, and they said there was.

So I completely disagree with that. That idea that the Georgia Fair Lending Act was going to shut down mortgage lending in Georgia was a really sleazy tactic that was employed to stop a law that we desperately needed in Georgia to save people's homes like Ms. Giles.

MS. BRAUNSTEIN: And I think we're going to need to make that the last word. And I want to thank very much our panelists. This was a great panel. We probably could have gone on with this discussion all day because there's a lot of topics we never did touch on. But we look forward to probably additional written comments from many of you. And again, I'd like to thank you. We will take a 15 minute break. We will start the next panel precisely at 10:45.

(A short break was taken from 10:32 a.m. to 10:47 a.m.)

MS. BRAUNSTEIN: Okay. We're going to started with our second panel. We've got a large panel of people, so we want to get started. And the same rules as before apply, each panelist has five minutes for their opening comments. You will get a yellow light when you hit four minutes and then the red light when your -- when the five minutes -- when your five minutes are up. And we'll start over on the same side of the table. Doug, why don't you kick us off. And please start out by introducing your name and what organization so we'll have it in the record for the court reporter.

MR. DUNCAN: Hello. I'm Doug Duncan, senior vice president of research and business development and chief economist of the Mortgage Bankers Association. The MBA appreciates the opportunity to discuss the macro economic impact of the non-traditional mortgage products here today. MBA is forecasting a soft landing for the economy and the housing market in 2006.

According to OFHEYO home price appreciation slowed to an annualized 8.1 percent rate in the first quarter of 2006, the first single digit annualized home priced gain since the first quarter of 2004. Their purchase only index shows an even more pronounced slow down to an annualized 5.3 percent in the first quarter.

In terms of originations, MBA's most recent data covers the second half of 2005. With short term rates rising last year, mortgage borrowers moved to fixed rate mortgage products, both for first liens and second liens. Non-traditional products, namely deferred amortization, also called interest only or IO loans, and payment option loans continue to be a significant part of the market.

In terms of volumes, traditional fixed rate loans represented 44 percent of the dollar volume originated, traditional ARMs 31 percent, and IOs comprised the remaining 25 percent of originations. While the majority of IOs are adjustable rate loans many with an initial fixed period for several years, a growing share of IOs have fixed rates.

In terms of the macro economic impact, we estimate that there were 690 billion of IO loans originated in 2005 out of a total of 2.9 trillion for the market as a whole. Payment option or option ARM originations accounted for 8 percent of the dollar volume of originations in the second half of 2005. Among those lenders who responded with a survey payment option ARM volume data, these loans comprised 12 percent of their originations for the second half of 2005.

Lenders have been successful at assessing risk, and this success has been reflected in low foreclosure and default rates. MBA's first quarter 2006 national delinquency survey showed that the seasonally adjusted delinquency rates stood at 4.41 percent at the end of the first quarter, down 29 basis points from the fourth quarter in 2005. The foreclosure inventory rate was 0.98 percent at the end of the first quarter, a drop of one basis point from the fourth quarter of 2005.

For several quarters we've been noting a number of factors, including the aging of the loan portfolio and increasing short term interest rates, which are putting upward pressure on delinquency rates. On the other hand, the strong economy and labor markets are offsetting positive factors that were particularly important in the first quarter. Going forward, we expect these same factors will continue to be important. Additional modest increases in delinquency foreclosure rates are likely in the quarters ahead.

We estimate that first-time home buyers represented almost one in three home purchases in the second half of 2005, given the increases in home ownership rates over the past several years, the marginal home buyer today is, by definition, a higher risk borrower than the marginal home buyer in prior years. However, to this point, society has determined that the positive externalities flowing from increased home ownership outweigh any negative externalities that may flow from lending to higher risk borrowers.

As an economist, it's sometimes frustrating to me that some of those engaged in this issue are unwilling to clearly state what they view as an acceptable rate of default. Some analysts and advocates will tell you that non-traditional mortgage products combined with weakened underwriting standards in a period of rising interest rates is a recipe for rising foreclosures. They contend this will lead to housing over supply in the market, a decline in house prices, and an economic down turn. I don't think this analysis is correct.

Let me share with you numbers that tell a different story. 34 percent of home owners own their home with no mortgage. 48 percent have fixed rate loans, leaving 18 percent with adjustables. Of the adjustables, 12 percent are prime leaving 6 percent of all home owners with subprime adjustable loans. The post-recession peak and foreclosure inventory was 9 percent for subprime adjustables, so round that up to 10 percent of that 6 percent and it gives you six-tenths of one percent foreclosure inventory of all homeowners in the presence of three million lost jobs.

We're predicting job gains in the foreseeable future. Even if foreclosures occur at twice the level of our historical data and in the presence of job gains, it would still be only 1.2 percent of homeowners and hardly enough to cause an economic downturn, although it might be enough to cause some problems in some local markets. I have additional data on the gains in consumer wealth as a result of home ownership and was hoping to comment on the impact of suitability, but I'm happy to take questions at your leisure. Thank you.

MS. BRAUNSTEIN: Okay. We'll have plenty of time to discuss those topics. Glenn?

MR. COSTELLO: Thank you and thank you for the opportunity to participate today. Good morning. My name is Glenn Costello, and I'm a managing director at Fitch Ratings. Fitch is the third largest bond credit rating agency, both in the U.S. and globally. As part of its credit rating business, Fitch assigns ratings to Residential-Mortgaged Backed Securities, known in short as RMBS.

I'm the co-manager of the RMBS business. I've been involved in RMBS ratings for 15 years. Let me take a moment to explain the RMBS ratings process as a preface to Fitch's role in analyzing the risk of mortgage products, including the non-traditional mortgage products that we're talking about today.

The central component of the RMBS rating process is evaluating the likelihood of default by some number of borrowers in a pool of mortgage loans and assigning probable recoveries to those loans once they have defaulted. For example, we might determine through statistical analysis that in the worst case no more than ten percent of the loans in a mortgage pool will default and further determine that

50 percent of the value of those mortgages could be recovered, or conversely that 50 percent of the mortgage amounts could be lost.

Therefore, our worst case expectation would be ten percent of the mortgage pool defaulting with 50 percent losses on the defaults leading to a five percent loss on the pool of mortgages. We could then assign our highest rating of AAA to a bond size equaled to 95 percent of the mortgage pool, reflecting our opinion that the probability of a loss greater than five percent was extremely remote. This is a very high level summary of the process we go through for the hundreds of mortgage pools that we rate each year.

As part of this process, it's necessary for Fitch to evaluate new mortgage products in order to determine the risk of default and loss posed by the terms of such products. This is a challenging task as the fundamental basis of our risk analysis process is statistical modeling of the historical performance of large numbers of mortgages over long periods of time. By definition, newer products, such as interest only mortgages, 40-year term mortgages, and pay option ARMs do not offer this sort of data for analysis. Therefore, a different approach is required. We analyze these products by reviewing the potential for payment increases, which are in some instances substantial and also the possibility of little or no or sometimes negative amortization of the mortgage balance.

We can compare these risk factors to those of more established mortgage products and, based on that comparison, assign conservative risk factors to the new mortgage products. This process is detailed in our rating criteria reports available at www.fitchratings.com.

To summarize Fitch's findings in researching non-traditional mortgage products, we find that these products can be structured and underwritten in a manner that provides increased financial flexibility for homeowners without creating undue risk of mortgage defaults. For example, our analysis indicates the addition of an interest only period to a mortgage of a borrower with good credit and well documented income and a reasonable ratio of debt to income does not introduce substantial additional risk. Also, a similar loan of a term greater than 30 years may also be only moderately riskier than traditional loan products.

However, Fitch is concerned about the combination of risk factors present in some non-traditional mortgages. We see combinations of non-traditional loan terms as a source of additional risk. For example, as we've discussed in our research, we do think there is additional risk in interest only lending to subprime borrowers, particularly when the loan is an adjustable rate mortgage and the borrower is qualified to the initial interest only payment.

Since borrowers can face payment increases of as much as 50 percent when the mortgage rate begins to adjust, lack of full income documentation only exacerbates this risk.

Forty-year mortgages can present some similar concerns. For the most part, Fitch does not view the extension of terms from 30 years to 40 years as a very large risk factor. Many, if not most, borrowers will have an opportunity to refinance or to move early enough in the life of the mortgage that the difference in amortization level is not so large. However, Fitch takes a different view of 40-year mortgage terms on pay option ARMs.

Since option ARMs allow the borrower to make a minimum monthly payment sufficient to amortize the mortgage at a very low rate, such as one and a half percent over the term of the loan, the extension from 30-year to 40-year terms allows for very low payments or, to put it another way, allows the borrower to afford at least initially a much higher priced home. The borrower's ability to absorb subsequent very large payments as the loan terms adjust is a source of risk that we must consider in our analysis.

So just to recap, you know, in Fitch's opinion non-traditional mortgage products when offered in conjunction with sound underwriting practices do not necessarily add substantial amounts of mortgage default risk. However, combinations of mortgage features that create large amounts of borrower leverage and/or risk of substantial payment increases may cause higher levels of mortgage defaults. Thank you.

MS. BRAUNSTEIN: Thank you very much. George?

MR. REYNOLDS: Good morning. I'm George Reynolds, senior deputy commissioner with the Georgia Department of Banking and Finance. Our department has responsibility for a variety of financial service providers, including banks, bank holding companies, mortgage lenders and brokers, and money service businesses. This broad range of supervisory responsibilities has given us a unique perspective on the impact of non-traditional mortgage products.

Our department has a long-standing tradition of taking a market-based approach to innovations in the financial service industry. Although concerns have been expressed by many regulatory agencies regarding the potential impacts of these products, let us first recognize that innovation in the mortgage industry has broadened the availability of financial services and has permitted individuals who previously may have been excluded from home ownership into the market. We believe that innovations that encourage participation by low income minority and other underserved groups should not be discouraged, provided that safety and soundness and consumer disclosure issues are appropriately addressed.

The Department has noted over the past 18 months a marked increase in the volume of non-traditional mortgage loans that could be characterized as subprime, that is to say, loans with FICA or beacon scores of 650 or less. These are credits that are primarily originated at licensed mortgage lenders and brokers, primarily supervised by the states rather than at insured depository financial institutions. The Department distributed guidance on our website that expressed caution regarding the usage of non-traditional products by marginal or inappropriate borrowers.

Individuals using these products as vehicles to facilitate home ownership, particularly to qualify for loans that they could not otherwise qualify for based on current income, could find themselves facing difficulty as these loans become seasoned. In the current market environment of rising interest rates, borrowers are faced with the prospect of rising loan payments. The real concern is that as borrowers are faced with the prospect of implementation of principal amortization, that marginal borrowers are going to be unable to service their increased monthly obligations and that non-performing loans or even increased loan foreclosure could be the result.

We recognize as state regulators the need for full and timely disclosures to borrowers to provide information on the risk and suitability of these products. It is noted the current methodologies for disclosures may be inadequate to provide consumers with timely and meaningful information that fully describes the optionality of these products and the impact increases in market interest rates and future principal payments could have on the consumer.

It's suggested that disclosures be moved forward in the decision-making process, be more specifically tailored to the loan products that are being offered, and involve modeling that is standardized between institutions so that consumers can validly compare product offerings. Disclosures should be sufficiently detailed to permit consumers redress if there are variances between disclosures and the final loan offerings at the closing table.

There are certainly questions as to whether the current approach regarding truth and lending disclosures can be tailored to fit unique features and complexities of these non-traditional mortgage products and provide meaningful disclosures to consumers. It's important to focus on a reasonable number of meaningful consumer disclosures to prevent consumers from being confused and to reduce the possibility of information overload.

I would also strongly echo the recent comments of the chairman of the Federal Reserve regarding the need for enhanced and improved financial literacy and education to better prepare consumers to deal with the complexities of the financial service marketplace.

Finally, it's vitally important that market discipline in the secondary market provides certain underwriting and suitability standards for purchase of these products in the secondary market. Enhanced expectations by the secondary market regarding underwriting and verification procedures could mitigate some of the risk concerns noted above. Care should be exercised to permit continued innovation and product development in the financial services marketplace. It's our opinion that regulatory efforts should be focused on better educating the public on the potential risks involved in these non-traditional products and ensuring that appropriate underwriting and disclosure standards are maintained. Thank you.

MS. BRAUNSTEIN: Thank you very much. Ken?

MR. LOGAN: Good morning. My name is Ken Logan. I'm a resident of Canton, Georgia. I serve as executive vice president of NovaStar Capital, but I'm here today in my capacity as chairman elect of the National Home Equity Mortgage Association.

I commend the Federal Reserve Board for its focus today on ascertaining the effectiveness of disclosure relating to non-traditional mortgage products. There's no doubt that mortgage lending in general and the new alternative or specialty products that have evolved over time, in particular, are complex lending transactions that are not easily explained to or understood by many borrowers.

We believe that the most important element in assuring the understanding of a residential mortgage loan transaction is consumer knowledge. Ultimately, an educated and knowledgeable consumer is best equipped to analyze and select the appropriate mortgage loan for him or herself. Four years ago NHEMA founded the BorrowSmart Public Education Foundation, whose mission is to educate the mortgage borrower directly and indirectly through training and supplying educational material to neighborhood housing counselors across the country.

While we are wedded to consumer education, we are also advocates of consumer choice. Improvident laws and regulations that restrict consumer choice will have the effect of limiting credit and will restrict the ability of borrowers to purchase homes of their choice and use the equity in their homes for matters of their choice. We do not believe that such a result is sound public policy.

The role of the real estate finance industry is to develop and produce mortgage loan products that serve the changing needs of Americans. Lenders strive to produce affordable, yet economically sound mortgage loans that the borrowing public wants. That effort is what has led our nation to be a nation of homeowners with the highest ownership rate in the country's history. That effort is also what brings us here today.

There are clearly a multitude of mortgage loan product choices to fill borrower needs and objectives. While the industry has provided and produced affordable loans for millions of Americans, the question persists as to whether the federal disclosure regimen has kept pace with the new products on the market. My answer to this question is that today's disclosure regimen with respect to non-traditional products does about the same job as it does with respect to the traditional mortgage products. Quite frankly, that performance is generally poor.

In my judgment and experience, despite the best efforts of HUD and the Board, few borrowers fully understand their residential transaction or the disclosures. The mortgage loan is an inherently complex transaction. And unfortunately, the layer after layer of disclosure required by federal law, state law, and by lender necessity does not help much and arguably makes borrower understanding more problematic. Accordingly, it is our conclusion that tweaking the disclosure regimen to address only non-traditional products will not result in the fundamental issue of whether the regimen serves the purpose of effective disclosure to borrowers from a macro perspective.

Consumers already receive an incredible array of information about the residential mortgage transaction through the RESPA, TILA disclosures, Reg Z, Reg X, and those additional disclosures required under Fair Credit Reporting and Equal Credit Opportunity Act, in addition to the various state requirements. The result of all these disclosures is to produce loan closing packages like this one, typically three-quarters of an inch thick and commonly totaling in excess of a hundred pages. I just note that I just counted up as a typical package, 42 signatures alone just on the disclosure portions alone.

So the problem is not the sufficiency or even the timing of receipt of information. Rather, it is NHEMA's position and my personal experience as a lender that the quantity and nature of the information disclosed is simply too much and detailed for the average borrower to digest over any period of time and that borrowers would be better served by simpler and more targeted disclosures. An overwhelming amount of information is available and provided while comparison shopping if borrowers so choose at application or within three days of it by federal law, if the terms change materially during the processing, again, by federal law, and then finally at the closing table.

And so called loan suitability is not the answer to the failure of loan transactions to be meaningfully understood by borrowers. If lenders are made responsible for the final matching of borrowers to loans, such a duty would be practically impossible to effect or create litigation chaos and cause a loss of credit options to many borrowers. Lenders cannot wear two hats. They cannot be both their own advocate and shareholder fiduciaries and a fiduciary for their borrowers also. It is axiomatic that one cannot well serve competing interests, and it is certainly true that both lenders and borrowers lose in the unfortunate event of a foreclosure.

In fact, if a lender does not allow an applicant to choose an available product for which they qualify, that lender may very likely be accused of discriminating against that borrower. Lenders cannot stop a borrower from choosing a loan program they qualify for nor should they be expected to. Each borrower's circumstances in total are very personal and unique.

In summary, NHEMA advocates a serious borrower education initiative to go hand in hand with meaningful, simplified residential mortgage loan disclosures. NHEMA is willing to lend its resources to this effort. However, revising the existing disclosure to address only non-traditional mortgage products is an inadequate solution to the overarching problem of the failure of the federal disclosure regimen to produce an understanding of the transaction comprehendible by the average borrower. Thank you.

MS. BRAUNSTEIN: Thank you very much. And before I go to you, Alys -- I'm sorry. At the beginning, I should have noted that Juan Sanchez has joined the panel, who is an assistant vice president and community affairs officer for the Federal Reserve Bank of Atlanta, and we welcome you, Juan. Alys.

MS. COHEN: Thank you. My name's Alys Cohen. I'm a staff attorney at the National Consumer Law Center. I appreciate the opportunity to be here today. And I'm glad to be here because the Federal Reserve Board is really in a unique position at a key moment in this debate. What is the debate about? It's about preserving home ownership for working families who do not have equal bargaining power in the marketplace.

The marketplace has gone awry. Unaffordable loans, non-traditional, and otherwise are rampant in the subprime market. And the risk for these loans is carried only by the borrowers. The risk is pooled in such a way that industry is making money without bearing the risk while people like Ms. Giles in the back risk losing their homes. We need to change the system.

The push marketing is characterized by concentrations, geographically and racial, of inappropriate loans, including in the non-traditional market. And let me give you some statistics. In the Wall Street Journal, an industry study projected that one in eight households with ARMs originated in 2004 and '05 will default. The six-month LIBOR has increased every month for over two years, and soon folks will be facing unaffordable resets.

And energy prices, part of residual income, are skyrocketing. Families below 150 percent of the federal poverty guideline spent about 20 percent of their annual income on energy costs. These are problems in refinancings and in purchase loans, and some of that difference is geographic.

In addition, non-traditional mortgage products are often associated with other abusive practices. Prepayment penalties that exceed the teaser rate period, yield spread premiums, fraudulent appraisals, and falsified loan application data. The first panel is not unrelated to this panel.

We need to revive underwriting so that loans are not sold on a buyer beware basis. We need to shift the risk so that originators evaluate what the maximum payment will be to the borrower, whether there will be any negative amortization, and what the residual income will be for the borrower. We need disclosures that are relevant to the borrower's loan. They need to be more specific and more comprehensive. They need to be early, and they need to be enforceable. And we need full assignee liability. We need the market to work for borrowers, and we need to stop practices before they happen and to provide remedies after the fact.

What do we recommend? First, we ask the Federal Reserve Board to use its authority under 15 USC 1639 (l)(2). What is that? That's the FRB's UDAP authority that was part of HOEPA. We ask the FRB to expand the interagency guidance that's coming out to all institutions involved in subprime lending and other forms of mortgage lending.

We also ask the Federal Reserve Board to make it an unfair practice to make unaffordable loans with alternative features, such as underwriting based only on a temporary rate, not considering residual income, and not underwriting for the worst case scenario, including the maximum rate, which is not the fully indexed rate under the loan, and any negative amortization. We also ask that the Federal Reserve Board identify as an unfair practice imposing prepayment penalties beyond the first reset date.

We also ask that disclosures be re-evaluated so that they're early, firm, and loan specific. That would include disclosure of the maximum payment and the maximum rate as part of the federal box, any negative amortization, the index that the loan is based on, and how one can find it if you're an average person, for example on the Web, and the length of the initial interest rate period.

The timing of the early disclosures needs to be changed so that they're relevant to someone who can use disclosures. People need a GFE of terms at least seven days before closing or within three days of the application, whichever is earlier. They also need early redisclosure if the terms have changed. There need to be consequences for originators and investors of loans that don't follow these guidelines.

We also ask the Federal Reserve Board to go to Congress as it has done in the past. We ask for rescission for purchase loan abuses because in markets where those are a serious problem, people have almost no options. We also ask for duty of good faith and fair dealing for originators, for servicers, and for appraisers. It's a flexible standard that can't be evaded by changing your practice slightly. Full assignee liability for the amount paid plus the amount remaining on the loan and a federal cause of action for private citizens under the FTC 9. Thank you.

MS. BRAUNSTEIN: Thank you very much. Kate?

MS. CRAWFORD: Hi. My name's Kate Crawford and I'm the subcommittee chair for the Consumer Protection and Affordable Housing Committees for the National Association of Mortgage Brokers, and I'm also a licensed loan officer in North Carolina. And I want to thank you for inviting NAMB to discuss the issues relating to non-traditional loan products.

NAMB's the voice of over 25,000 mortgage brokers throughout the country. Our members are independent small business men and women that adhere to a strict code of ethics and best lending practices when guiding consumers to the loan process. We provide an efficient market mechanism to deliver loan product choices where banks, lenders, and others do not venture. NAMB believes there are five critical tools consumers need to choose a mortgage, traditional or non-traditional, to shop effectively and make an informed consumer choice, consumers need revised mortgage comparison tools that are uniform and consumer tested, a competitive market that is free from false distortions, educated loan originators, a mortgage marketplace that weeds out bad actors from all distribution channels through criminal background checks and financial literacy.

Today consumers are given -- are not given the tools needed to shop effectively for mortgages. Disclosures that lack uniform information are laden with legalese to prevent consumers from being able to comparison shop. For example, today only mortgage brokers disclose in the GFE that they can earn indirect compensation when a loan closes. Although lenders and bankers also earn this indirect compensation in the form of service release premium or gain on sale, they are not required to disclose such income. This uneven disclosure requirement has led to consumer confusion, hampered the ability of the consumer to compare apples to apples when shopping for a loan product from different distribution channels.

NAMB proposes revising current shopping tools to make them effective, as well as account for market innovations and non-traditional mortgages. We believe the government should revise the CHARM booklet, as well as the special information booklet to include information about the features, risks, and benefits of non-traditional loan products. For example, these booklets should contain information on what happens to a loan's monthly payment after the loan teaser rate expires.

Consumers test the new and revised booklets to ensure the utility and effectiveness as information sources for consumers, consult with the task force that represents the current mortgage marketplace, and obtain industry and consumer input when revising these booklets. Revise the GFE so it mirrors the HUD-1, is one-page in length, and provides valuable information to the consumer, meaningful estimates of closing costs and monthly payment, enforce existing laws to effectively eliminate deceptive or misleading market practices and communications with consumers with respect to any loan product type, traditional or non-traditional.

Most significantly, any new or revised disclosures for any loan product type must meet the disclosure of rate, fees, costs, and points uniformly regardless of distribution channels chosen by the consumer. In so doing, we will give meaning to the ability to comparison shop. In addition, we must protect consumer choice by maintaining a competitive marketplace that is free from excessive government intervention or regulations that distort competition equity among the various distribution channels.

We should not ban products from the market, nor should we even attempt to set compensation or de facto usury caps. These efforts have failed in the past. Rather, it should be left to market forces, simple supply and demand, to determine the utility and longevity of any loan product. Consumers are the only ones that should select their mortgage, not the government, consumer advocates, banks, lenders, credit unions, or mortgage brokers.

Third, we must ensure that every originator that handles the 1003 application is required to complete both free employment and continuing education requirements. Each and every consumer deserves to work with a knowledgeable loan originator, especially when considering non-traditional loan products that are inherently more complex.

Fourth, we should ensure that all loan originators submit to a criminal background check so that the bad actors are not able to move freely from one distribution channel to another. Lastly, we must ensure that consumers have the financial acumen necessary to shop for loan products and make informed financial decisions. This means that we must allocate funds across the financial literacy programs in this country starting at the middle school level. Thank you.

MS. BRAUNSTEIN: Mike? Thank you, Kate.

MR. WRIGHT: Good morning. I'm Mike Wright, representing both Prudential Georgia Realty and the National Association of Realtors. The National Association of Realtors has been concerned about the impact of predatory lending on homeowners for many years.

In 2005, our board of directors on which I serve approved a report from our subprime lending work group. The subprime lending work group report encourages realtors to help consumers avoid predatory lending and support strengthening the Home Ownership and Equity Protection Act, including expanding its coverage to incorporate purchase money mortgages and lowering the triggers.

As part of implementing the subprime lending work group report, the National Association of Realtors has issued two consumer education brochures, one on traditional mortgages to assist consumers in understanding the options and the other on non-traditional or specialty mortgages to assist consumers in understanding the risks and advantages. Both of these brochures are available in Spanish and English and are readily available to our members for use with their customers and clients.

The National Association of Realtors strongly supports most of the proposed non-traditional mortgage guidelines being developed by the banking agencies. We are concerned, however, that if the guidelines require banks to approve borrowers for non-traditional mortgages, only if their income today is high enough to handle the fully indexed mortgage payment, which kicks in after several years, families whose income can grow to meet the future obligation will be denied access to home ownership.

We strongly support enhanced disclosure of the potential future impact on monthly payments as a result of rising interest rates and the impact of equity due to negative amortization. My business experience includes most of the traditional special lending options available today. I started selling real estate as an agent when traditional mortgages were about the only way that consumers could finance a home. Now, in my role as managing broker, we are aware of a new specialty product practically weekly. As a general rule, most of our transactions are completed using traditional financing. However, we have seen a steady rise in non-traditional or specialty financing over the past several years resulting in the highest ownership levels in U.S. history.

One of the biggest challenges for the real estate associate today is understanding the terms of the proposed loan with enough advanced notice to be able to offer counsel to his or her clients prior to the closing. We believe that an informed consumer is in a much better position to understand the risks associated with all loan products and is, therefore, less likely to suffer payment shock down the road.

These issues can be greatly reduced through enhanced disclosure of all of the loan terms early in the loan shopping process. This early disclosure will also allow real estate agents to suggest to their customers that they consider other lending options when it is apparent that they are being steered toward higher risk, non-traditional financing unnecessarily. The bottom line is that as realtors we continue to seek ways to assist our clients in becoming informed consumers as they seek the American dream of home ownership.

MR. BRAUNSTEIN: Thank you, Mike. Allen?

MR. FISHBEIN: Good morning. My name's Allen Fishbein, and I'm director of Housing and Credit Policy with the Consumer Federation of America which is a federation of some 300 consumer organizations that tries to promote the consumer interest. We appreciate the opportunity to be invited to appear here today, and we want to commend the Fed for holding these hearings to investigate ways that consumer protections need to be strengthened or revised in light of changing market conditions and the new problems that are emerging that pose threats, we believe, to sustainable home ownership.

CFA's concerned about the mass marketing of non-traditional mortgage products, products such as interest only loans and payment option adjustable rate loans, particularly to vulnerable borrowers, such as first time home buyers, modest and fixed income borrowers, and those who rely on higher cost subprime financing to purchase homes and refinance their properties. Evidence suggests that these groups are less financially savvy and more susceptible to victimization from abusive and predatory lending practices.

The majority of subprime adjustable rate mortgage borrowers have loans that are due to reset in the next two years, and rising rates could mean that these loans are unaffordable to refinance for some portion of borrowers. It's been estimated by reliable industry estimates that one out of eight of these loans could default, which is an indication in our mind that they were not well underwritten to begin with and that something's amiss in the mortgage finance market that permits these conditions to exist. Existing consumer protections in such cases may not be enough to protect those who are facing these problems from being victimized and preyed upon by unscrupulous lenders, and changes in consumer protection will be needed.

Non-traditional mortgage borrowers generally have been described as wealthier with better credit profiles than the typical mortgage borrower and often as -- as choosing these instruments as financial options. However, recent CFA research that analyzed the database of some 100,000 mortgages found that this often is not the case. Example, one out of six interest only and one out of eight option ARMs borrowers had incomes that were at or below the median income of 44,000. More than one-half of payment option ARM borrowers and 38 percent of interest only borrowers had credit scores under the median credit score with one out of five option ARM borrowers and one out of eight interest only borrowers having credit scores under 660.

This segment, therefore, is particularly vulnerable to the payment shocks that are often featured in non-traditional products. CFA believes that more could be done to ensure consumers are fully aware of financial risks of the complex and potentially risky mortgage products that they choose. And we have some specific recommendations.

One is we believe consumers need timely, clear, and balanced disclosures to help them make wise choices, certainly in view of changing market conditions. And the proliferation of a bewildering array of new products, loan disclosure rules need updating. Reg Z should be revised to reflect key informational needs for consumers considering deferred interest and exploding products. And certainly the CHARM booklet and certain booklets that are geared to non-traditional products ought to be provided to consumers. But even so, we don't think that's enough, and expanded consumer protections will be needed.

We believe that the interagency guidance as proposed ought to be adopted, but recognize at the same time there are limitations to it. It's not enforceable on the part of individual consumers, leaves out key actors in the marketplace, and we believe ultimately it does not go far enough. Therefore, we believe that the Federal Reserve Board also should be exercising its unfair and deceptive practices authority to apply certain rules in the marketplace more broadly. Some of these specific practices that ought to be prohibited were mentioned by Alys Cohen in her prior remarks.

Third, we believe there's a need for mortgage broker fiduciary standards to put the issues squarely that they are representing the interest of borrowers or alternatively, the establishment of suitability standards or a duty of good faith and fair dealing for lenders and mortgage brokers more broadly. Next, we believe that the HOEPA protections ought to be expanded to cover more loans. They should include yield spread premium and prepayment penalties in the points and fees calculation, lower HOEPA thresholds for points and fees, rescission remedies that would apply through HOEPA for purchase money mortgages. And lastly, let me say we believe that assignee liability ought to be extended to promote greater accountability in the secondary mortgage market.

MS. BRAUNSTEIN: Thank you very much, Allen. Thank you to all our panelists. We're going to open it up for discussion. One of the things that we heard in previous -- well, we heard a little discussion of this in the previous panel, and we heard in other HOEPA hearings, especially around the non-traditional mortgages were a lot of concerns around stated income. And I heard a little of that but not a lot here.

And I was wondering if anyone would like to comment further on that. We heard that that is a practice that can be abused, and it's something that we ought to be concerned about quite a bit. So I didn't hear a lot this time, and I'm kind of curious about that. Who wants to start?

MR. DUNCAN: Excuse me. I'll just make a comment about broad aggregates in the marketplace. We've looked at the loan cohorts that are out there and, particularly, those which are securitized. We tend to find that the credit scores on those kinds of loans tend to be significantly higher than for loans where you have fuller documentation. So the market appears to be assessing the risks related to the lack of information by taking the pieces of information that they have and raising standards, so be it in the aggregate.

MR. REYNOLDS: Just to comment from -- in terms of the results of our examination program. I think we have seen a correlation between the inappropriate use of stated income and the prevalence of mortgage fraud. In the case of some lenders, we have had to, in administrative actions, address the appropriate use of stated income and make sure the -- that it's only being used in an appropriate sense and not being used as a way of circumventing normal underwriting standards.

MS. BRAUNSTEIN: How have you found that and addressed it? I'm just curious.

MR. REYNOLDS: Well, I think it's -- There are very few situations, I think, where stated -- use of stated income loans are appropriate. And you have to look at the employment situation of the borrower to make sure that it's appropriate. You know, if it's an individual that has a normal employment status where they're an employee, I think the use of stated income is inappropriate. It's very similar, I think, to low documentation loans. I mean, we've noted a prevalence between low doc loans and also the prevalence of mortgage fraud.

And as a department, we have been very intently focused on mortgage fraud as a priority. And I think some of the practices that were described in the previous panel, I mean, to us are obviously out and out mortgage fraud and have been a focus of concern for the department.

MR. BRAUNSTEIN: Alys, were you going to comment?

MS. COHEN: The experience that we see from attorneys around the country is that no doc and low doc loans are essentially used to create fraudulent income for borrowers on fixed incomes or on low incomes. And as far as we can tell, the only reason you need to do a no doc or low doc loan is either because the borrower doesn't want to report their income to the IRS or the originator wants to fake the income and make an unaffordable loan, and we don't need to get behind either one of those practices. So we would like to see them eliminated. They're called liar loans in the industry and there's a reason for that.

MR. COSTELLO: One quick comment I want to add there just to amplify on that. You know, it has been true in the mortgage pools that we've seen in the securitization market that traditionally the use of stated income was to borrowers who are not people who received wage income and didn't have, you know, the same kind of income statements that someone who received wages did, so it's self-employed borrowers for the most part. We found, in fact, and to Doug's comment, they both had higher credit. But what's been interesting is over time their performance in terms of defaults has not been worse than those people who did have full documentation, suggesting that there was an underwriting process going on that did account for the fact that borrowers were using stated income.

Having said that, I mean, we have seen more of what's been discussed here occurring more recently, which is borrowers who do have wage income who can presumably document their income choosing not to. And that is a concern for us in terms of an incremental risk that some people are, you know, above and beyond just the fraud issue but that people are stretching, you know, to basically, you know, give an income number that will help them afford a home in some of the markets that have become so expensive.

MR. CHANIN: Glenn, let me follow up on that. In terms of where you haven't seen a problem with the stated income loans, has that analysis been done regardless of income level or has it been at the higher levels, whatever that’s defined, or across all income levels?

MR. COSTELLO: It's -- You know, we've looked at all income levels. We've actually focused on it more in the subprime market because that's where, you know, we've had concerns about it in terms of potential risk. And that's where I can state that, you know, recent analysis of historical performance, you know, hasn't indicated a, you know, significant amount of additional default.

MR. FISHBEIN: Yeah. I just want to comment on that, as well, and I think what -- the point Glenn made is a correct one. I think relying on historic analysis has certain limited application here because the growth of stated income, particularly, seems to have occurred recent years as affordability has eroded in many markets. And so that certainly opens and suggested a new category of borrowers coming in that's not the traditional borrower of stated income. And that should be a cause for concern.

Certainly a lot of anecdotal information, as Alys mentioned, to suggest that these loans -- these features are being used inappropriately, and I'll just mention one personal reference. A CEO of a large mortgage lender told me that his son was trying to take out a mortgage loan, was informed he didn't have sufficient income to pay for the home he wanted to buy. In which case the broker said, well, why don't you just go stated income loan instead, so.

MR. SANCHEZ: I've got a clarification. Is stated income the primary form of mortgage fraud, per se, or is appraised values? What -- Something was eluded to earlier that talked about appraisals, and I just wanted to ask that question.

MR. REYNOLDS: Well, our experience is that mortgage fraud can come from a variety of areas and we see mortgage fraud related to appraisal alterations. We see mortgage fraud related to income that has been basically changed on loan applications. We see issues related to stated value and other concerns. So I don't think any one area can basically be said to be the main source of mortgage fraud.

MR. CHANIN: In an ideal world, at least in my view, consumer disclosure should be the solution to everything. That is, if they were perfect and if consumers read them and understand them and use them, then, you know, we wouldn't be having these discussions in terms of all of these problems, I think. That is, if the disclosures were there, people read them, said, no, this loan's not for me. But that obviously does not occur and probably will never occur because of different levels of financial sophistication, etc.

The prior -- and this question is for Kate and Ken. The prior panel indicated a number of instances of I'll call it abuse. And one example they gave was, for example, a -- I don't know if it was a broker, but a lender who made a loan, I think a refinancing, where the consumer's income -- fixed income, I believe, was $1,000 per month and yet their mortgage payment was $800. And that leaves aside real estate taxes. I don't know if there was insurance. And thus, the consumer is left with $200.

Again, ideally, consumer disclosures would fix that. The consumer wouldn't get that loan. If I were in my former home of Macon, I would have invited the person into my home and then sicked my dog on him. But the question is, so what do we do about that, aside from having criminal background checks? That is, how do we address those types of issues where either brokers or lenders are simply not doing what is appropriate in the circumstances? They're making loans -- and I think we'd agree an 80 percent debt to income ratio in that instance is a loan that should not be made. So how do we address that particular circumstance?

MS. CRAWFORD: Until there's adequate enforcement of some of the laws, it's going to go on. There's a lot of crooks in every industry. And obviously, this person that did this, whether whatever -- wherever they came from was not out for the benefit of the consumer but for the benefit of their pocketbook. And clearly, that loan should never have been made.

There are underwriting guidelines, and there --

and every loan is looked at by at least two or three different set of eyes in my office, and then it goes to a different place for a final decision. And I do think that maybe the underwriting guidelines should be toughened up at each lender, not necessarily a federal standard, but at each lender. And the lenders that made this loan need to get their act cleared up, too, because underwriters have quotas they have to meet, too. Everybody's got a quota they have to meet.

And the other thing is if there is a bad broker, the lenders need to stop doing business with that broker, and they don't. They continue to -- They might get cut off by lender, but they'll get signed up with somebody else. And that's the same way with some of the small banks that are brokers and some of the mortgage bankers that do it, too. If they're doing a bad practice, they might get cut off by one lender, but they keep on getting signed up with somebody else because it all boils down to your bottom line. It needs stricter enforcement.

MR. CHANIN: Ken?

MR. LOGAN: In reference to that loan example, let me just clarify. I've been a lender for a number of years, but my role now is as a warehouse lender. So I provide the capital to fund those loans. What I would question on that particular example is knowing what I know about the secondary market is -- you know, I'm not aware of any lenders that have an 80 percent debt ratio as a qualifying criteria, nor any that would allow somebody with $200 of disposable to make that loan.

So I would really suggest the enforcement issue clearly is an area that would help flush out the fact from the fiction about that loan and whether the actors were just the broker, was it a broker and loan officer, was it, in fact, the borrower involved in it. And I would surmise, not knowing the deal, that there was probably additional information that was actually provided somewhere in the chain that was inaccurate. And that -- You know, at that point in the process, those people should be dealt with.

In reference to another example where the, you know, purported 180 or 200 percent loan to value loan, again, I don't know of any process or any loan products out there that would do that sort of a mortgage. I believe there was an appraisal in there that indicated it was, in fact, a 90 percent loan or 95, whatever the number was. And that, you know, there was supposedly an inaccurate appraisal.

Same thing. I believe the examiner, Joan, indicated they look at all the loans. Having been at the banks that's been examined, they look at all production, sold or unsold. It's not a singled out portfolio. They look at production.

So I would suggest that between the states examining the brokers and the lenders for patterns and practices and the circumstances that, you know, sound on the surface to be so horrific need to be investigated. And if you find that in fact that occurred, then that needs to be what's dealt with.

MS. COHEN: Can I take a try at this question?

MR. CHANIN: Sure.

MS. COHEN: Even though I have a different name, and you didn't call on me. Thank you. I'm all in favor of enforcement. I was an enforcement officer with the Federal Trade Commission for five years. Enforcement's great. Compliance with underwriting rules is great.

Good people like George Reynolds and Barbara Kent have been doing enforcement for decades, and we still have a huge problem. So I want to quote George. He said, we need market discipline. The example that everyone's discussing this morning is one example, but it's not an isolated instance. And so it's not something where we can say, oh, you just get rid of that bad guy and everything will be fine.

We need the originators to impose rules that their employees will follow, and we need the investors to create guidelines and enforce those guidelines so that there isn't a flow of money into loans that shouldn't be made. With underwriting and assignee liability, you will have market discipline and the practices will change.

MR. FISHBEIN: Leonard, could I make an observation, as well?

MR. CHANIN: Sure.

MR. FISHBEIN: We started out talking about disclosures in the perfect world. And I think we're an organization that believes in financial education and certainly full disclosure to consumers about risks involved in loans. But we also recognize it's going to be a significant segment of consumers, which is just not going to work for them.

And so the question becomes where do they turn. Wealthier people can turn to trusted advisors. And if they don't, they perhaps are in a better position to pay for the mistakes they make. More moderate income people are not in that position, less likely to have trusted advisors that could explain the complexity of the products that are available in the marketplace today.

It seems to me we have a force out there, the mortgage brokers who are professionals. What is not required of them typically is that they have a legal obligation to the borrower to put them in the best loan for which they're suited. And by changing that standard, it'd certainly be a way of using the expertise of the mortgage brokerage force that understands the complexity of these products, can compare products, and try to narrow the choices that consumers have to make.

But what's missing is that, as we know, they aren't necessarily operating in the interest of the consumer in any particular time and that their compensation structure is such that they may not be motivated to put the consumer into the best loan, the cheapest loan for which they qualify. So we think getting at that issue for the channel that's responsible for majority of mortgage originations today and in the subprime market even larger than that is an important consideration.

MR. CHANIN: Thank you.

MR. SANCHEZ: I've got a question -- I'm going to shift gears here for a moment -- regarding the IOs, and obviously the state of Georgia is a state where IOs are very popular. You had made a comment that 25 percent of closings were IOs. And I'm just curious whether you have information as to who's taking the IOs, who's getting into those mortgages themselves, and what's the probability of default?

MR. DUNCAN: Well, there is some data available from the secondary market on the structure of the households and their credit characters. I don't have that in front of me. I'll be happy to supply what we have on that. The performance characteristics on those loans to this point have been very comparable to fixed rate products because, in fact for many of them, there's -- the initial structure of interest only period is fairly long, five to ten years. When they initially came out, they were shorter periods. The market assessed that those were actually a little riskier than were IOs which had longer payment terms because households have more time to adjust their income.

But a critical component in evaluating the risk is to what standard -- not standard, but to what rate or what terms is the loan underwritten. If it's underwritten to the fully indexed rate, then just because there's a teaser rate doesn't mean that the borrower is going to -- doesn't have the capacity to take on the fully indexed payment because that's where they were underwritten in most instances. It's just whether between that time period that they got the teaser rate and what it adjusts if they manage their money well. And that's where I think you see the differentiation in their performance from -- from fully amortized fixed rate kinds of products.

MS. BRAUNSTEIN: Doug, I'd like to follow up on that a little bit because we've heard conflicting information from various people as to how many of these actually are, though, underwritten at the fully indexed rate because I think what we've heard, and even from our own work in doing some horizontal reviews in lenders, what we saw was actually that a large percentage of these loans are underwritten at the teaser rates. And you know -- And I'd like to hear what you think. And also, what Glenn thinks in terms of the rating -- the risk rating of these. And is that something that you look in rating these as to how they're underwritten at which rate?

MR. DUNCAN: Well, they're clearly not all underwritten at the fully indexed rate. Whether a large share -- and I'm not sure how you define large, and I don't want to parse that word. But no question, a significant portion of loans are not underwritten at the fully indexed rate. But there are reasons for that.

If you take a 10/1 that amortizes principal for the last 20 years of a 30-year period and compare that to a 228, you will find that underwriting to the fully indexed rate would disadvantage the prior mortgage, and that may well be in the best interest of the consumer to take that loan. So the loan doesn't get underwritten at the fully indexed rate. But it's with consideration that the consumer has an option that -- which depending on how you make the calculation may work better for them. So we're not arguing that all loans are. I don't know what your data show.

MR. COSTELLO: You know, I agree with Doug's comments. Just a couple of things that I would say in terms of trying to segment the market. You know, if you look at borrowers with prime to -- you know, to average credit, the prime in the all day markets, as we refer to them, those borrowers, you know, there -- a significant percentages of them are taking IOs, probably the majority in some of the pools that we see. We don't view those as particularly risky, even if they are underwritten to the initial rate because the initial rate does tend to be very long: five, seven, ten years. So I'm not sure if you can call something a teaser if somebody's going to be paying that rate for ten years.

When you get into the subprime market, however, it's a little bit of a different story. In the subprime market, while the IO term might be for five years, that borrower's often in an adjustable rate mortgage. The adjustable rate mortgage is going to adjust after two years. And so if that borrower is underwritten to the initial IO payment but they're still facing a large payment shock due to the adjustment of the ARM not to the IO adjustment but the ARM adjustment at month 24, that's when we sometimes see, you know, very substantial payment changes at month 24.

Now, our analysis of how bad this is at this point is largely hypothetical because we really haven't seen borrowers at the point when that reset comes where they don't have an option to refinance into a new loan or make some other kind of a change into a different product. But it is something that we've noted as being the one segment that is concerning. And I definitely can state that among the subprime lenders whose pools that we analyzed, they are for the vast majority are underwritten to the initial rate.

MR. DUNCAN: Just to piggyback on that to extend some of the earlier data that we -- that I presented in my verbal commentary on delinquencies and production, what we've seen in some of those households are the prepay rates on the subprime product is much faster. And when I commented on the shift from adjustable to fixed rate products, what we're seeing is many of those households that are in that category are now refinancing where the fully indexed adjustable rate is actually greater than what a fixed rate IO would be. So as long as they've been making their payments, they're able to make those shifts to manage affordability across products.

That said, clearly in our most recent delinquency release the one group which saw a rise in delinquencies was the subprime adjustables. So we're not naive about that, but adjustables always have a higher delinquency rate than fixed rate, even in the prime market.

MR. MICHAELS: I want to take this discussion a little bit further. And for some time the Federal Reserve has been hearing from consumer advocates in a number of different contexts, not just these hearings, that what we need to do is focus consumers not just on what their payments will be when the rate becomes fully indexed, but that we ought to have disclosures that are geared towards what consumer's payments will be under the worst-case scenario for the loan over the full life of the loan.

And to take that one step further, I think I've read in some of the written materials for today's hearing that there are some who would advocate that that not just be a matter of disclosure, but that there be underwriting based on worst-case payment over the life of the loan. And that raises questions in my mind about how you underwrite a worst- case payment for events that may occur fairly long term, whether it's, you know, five years, seven years, or ten years when what you have for the consumer is affordability that's based on current financial data. And this really is for virtually everybody here on the panel today.

You know, what are your thoughts about the ideas of dealing first with disclosure of worst-case payment scenarios and then with underwriting that goes beyond just the fully indexed rate but to some, you know, worst-case scenario?

MS. CRAWFORD: I'll start. Talking with my customers every day and doing adjustable rate mortgages and pay option ARMs and interest only, I do show them the worst-case scenario. So I do that now. And if they don't ask, I show it anyway because I want to make them known about what they are getting themselves into if they want that loan. And if they don't want that loan, they'll usually do a 30-year fixed rate. And frankly, right now, 30-year fixed rates are about what everybody's doing, except for the interest only because the fixed rates are better than the ARMs right now.

As far as underwriting to the worst case, the main reason a lot of people will use an adjustable rate mortgage, and you can probably attest to this, is your three -- three-ones, five-ones, seven-ones, they're not going to be in that house more than three years or five years. That's their plans and the way that they -- they might be transit or they're with a company that's going to move them around or maybe they're just going to retire in a couple of years.

What's the point of trying to get them into that higher payment and tell them that they're not going to be there to have that higher payment. They're going to be there for three or five or seven, and that's it. I don't see any point in going -- going into the worst-case scenario.

Standard underwriting guidelines have worked in the past for the three, five, seven, and ten, and they aren't broke. I wouldn't try and change that. The one-year ARMs -- The one-year ARMs, they are underwritten to the fully indexed rate or the second year adjustment, and that has always been an underwriting guideline for the industry, as well. So I would keep it the way it is.

MR. WRIGHT: I'm jumping in here, also. I totally agree with you, Kate. What I think the vast majority of realtors do -- I know that certainly with my agents I can speak specifically -- that is part of the initial interview is asking not only the type of home the consumer's looking for, but you know, how do they plan to be there, what are their long term objectives. And I think it makes no sense whatever to somebody that is going to be working maybe for a large corporation whereby by standard practice, they're moved within a five-year period of time.

It may make total sense for their financial structure to go with some sort of an ARM or an interest only that may not index up until five or seven years out. They're not going to be in that house. And so to look at worst-case scenario 30 years out, basically prevents them from getting into that house, which I think is not good for anybody.

MR. LOGAN: I'll make a comment on this one, as well, probably more as a personal comment than as a NHEMA position. But you know, when you try to do a calculation as you described if you use worst-case scenario, you know, you have a numerator and a denominator on certain of the equations, and you'd be having to assume a certain probable increase in income. You would have to be assuming probably zero prepayment of the principal, which would certainly impact what the payment might be at the time of that worst-case scenario.

And so, the amount of assumptions that would have to go into that calculation if you tried to do much in the way of saying this is what your payment would be would just simply be inaccurate in any really material manner, unless throughout regulation you stipulated you had to -- everybody had to assume the same exact presumptions, none of which are very likely to occur, but you would have to at least establish some standard to do the equation on, so it has actual comparability and usefulness.

The other aspect of it would be in terms of qualifying. You know, if you give borrowers the explanation of this is the payment, and just as a quick example, on a typical $200,000 loan done at 7 percent, and if they believe that they're going to be in that house three to five years, the amortization alone is about $6500 in principal. So they could save $163 a month on their payment if they chose that.

And the trade off is they would not amortize that loan $6500. Well, if they happen to be intending to move --

move up, you know, various things could be going on there that would impact that. So it would take so many assumptions, which could be done. But the fact is that the ten-year historic average is already provided on ARMs. And, you know, to the extent that that history repeats itself or gives you some indication of what's going to go on, it would seem that that look back would be as valuable as any sort of very hypothetical equation you might calculate.

MS. COHEN: The discussion that we're having now I've often heard in the context of a related question. I appreciate your question, Jim. And the related question is about well, what about if someone has a 228 or a five-year ARM and they know that they're moving in two years. And the last time I heard that question posed was at the FTC workshop. And one of your colleagues, April Bresla (phonetic) at another agency said the following, you are requiring that person to move in two years. You're not just allowing them to move in two years.

And so part of the question here is, what does it mean to say I know I'm retiring in two years. What if your wife ends up with a medical condition and you can't retire in two years? So people have projections, but they're not always what's going to happen. Clearly, the worst-case scenario is not going to be what everyone experiences. But what we're seeing is someone's impression now about the future is assumed to be true.

We're also worried about the fact that the LIBOR keeps going up. I've looked at the history of the LIBOR over the last couple of decades. It's clear it won't always go up, but right now it is. And that seems relevant to the discussion also.

MR. MICHAELS: I'd like to take this discussion and move it a little towards the disclosure question, which is that for those of you who don't believe underwriting based on worst-case scenario is either feasible or makes any sense, you know, what does disclosing a worst-case scenario do to a consumer in terms of making them focus on affordability because really we've heard a lot of discussion about disclosures of worst case, and I've actually heard someone in the industry say that makes some sense.

MR. WRIGHT: You're looking at me?

MR. MICHAELS: Well, I thought I saw -- I thought I saw in your statement --

MR. WRIGHT: It certainly makes sense from my perspective. I think the cross cutting issue is clearly marketing. Lenders don't want to unnecessarily -- It's kind of like the auto industries years ago. They didn't talk about auto safety because even if they thought their car was a little safer than another car, they didn't want the consumer to start thinking about safety. And that's what we have going on here. They don't necessarily want to direct people to thinking about what the maximum mortgage payment they may have to pay. But I think to make the case against providing that type of disclosure to consumers really doesn't stand up.

But you know, this notion of choice, I think, really has to -- has to be probed a little bit because what we found in research we looked at was that the income levels were really critical, that, you know, consumers above $75,000 in annual income viewed non-traditional products as a financial option. You know, some of the considerations that we hear around the table here, they made choices: well, I'm going to be here, I'm going to move.

But for the consumers that had non-traditional mortgages under 75,000, overwhelmingly they said, this was the only way I could afford that house. This was not an option. And they took it on because they had no other choice. They're relying on home price appreciation to enable them to continue to make higher payments should they come, and that's a risky proposition for consumers. And certainly, that's the kind of proposition that needs to be fully disclosed.

But I think, you know, underwriting that takes into account a borrower's realistic prospects for being able to entertain higher payments down the line is absolutely critical because if we don't provide that, you're essentially -- and by the way, lenders have told us that they do account for that. They call it a fudge factor. I don't know what that means. I don't know how precise that is. But lenders tell me for part of their underwriting, and these are lenders who you would think of as being very prominent, that they do account for. So I think at least looking at that issue and figuring out how far we can go beyond a -- the fully indexed rate makes a lot of sense.

MR. DUNCAN: I would just like to bring up something that Ken mentioned earlier when he held up his package of things that has to be signed. I don't think there's any disagreement of any of us at the table that consumers should have clear information on which to act. There's disagreement on exactly what that means. What's composed? But I think we all agree that a well-educated, well-informed consumer with the power of information to shop will always get a better deal than a consumer that doesn't have that. So I think it's an issue of what's in that.

Is the worst-case scenario a piece of that? I don't know. All the things that Ken said makes sense in terms of how you arrive at that, what the standard is. I would say that in terms of the magnitude of the problem, while we have lots of anecdotes and anecdotes are very useful for illustrating a point, something to be looked into, they're not a good basis for public policy.

And our data -- broad-based data, which we've been surveying delinquencies and foreclosures since the early 1970s does not show a broad-based systematic problem at this point. Obviously, we're -- a lot of these loan products are newer, so we're looking to see what's going to emerge in that arena. But I think we actually have a lot of agreement at the table about some things that need to be done.

MS. BRAUNSTEIN: I'd like to take it back to something, Doug, you just mentioned in terms of ideally everybody having sufficient information in order to shop, being the key word. And I'd like to have a little bit of discussion about that because what we have heard is that while it's possible that people, in general, do some shopping for purchase money, there's, in fact, very little shopping that goes on in terms of refis and that it's really through push marketing that these things get done, that they're approached by lenders, as opposed to going out and looking for lenders. And I'd like to get some reaction from everybody on that whole issue.

MS. CRAWFORD: Well, my customers shop because they've already called several places before they call me, and they want to know how much it's going to cost them, what the rate's going to be, and what the payment's going to be. And that's what they're interested in up front. And then they start ask -- And they want --

MS. BRAUNSTEIN: How do they get to you?

MS. CRAWFORD: How do they get to me? I'm in the phone book.

MS. BRAUNSTEIN: Phone book? So you're not --

MS. CRAWFORD: I don't --

MS. BRAUNSTEIN: -- pushing in neighborhoods and --

MS. CRAWFORD: No. I don't do that.

MS. BRAUNSTEIN: And you're not -- They're not coming to you through internet or they're coming to you --

MS. CRAWFORD: We have a website.

MS. BRAUNSTEIN: -- by telephone?

MS. CRAWFORD: We have a website. We don't do any -- We don't do direct mail. We don't do any -- We don't have a call center. We just -- They just come to me because I've been there for 30 years.

MR. REYNOLDS: My observation and part of preparing for this, I went to our consumer area and pulled a couple of adjustable -- excuse me, interest only type mortgage products to take a look at the disclosures. And my observation is that the disclosures are fairly comprehensive that are in most of the products. The problem, I think, is there's such a volume of disclosures and the -- you know, it's one thing if you're a regulator that's been involved in the business for almost 30 years. It's another thing if you're a consumer and not a sophisticated consumer. So I really think the process needs to be simplified and that certain standardized information be provided to consumers so they do have the ability to better compare products between individuals that are offering product.

MS. BRAUNSTEIN: And George, would that come through -- If they're shopping, would that come through disclosures or more through advertising?

MR. REYNOLDS: I think ultimately it needs to come through the disclosure process because I just think it needs to be simplified. There needs to be clear disclosures, maybe fewer disclosures but more disclosures -- simple language disclosures so that the consumer is aware of what the optionality in the product is and so they can compare competitive product to get the best deal for that consumer.

MS. BRAUNSTEIN: I want to -- Mike, on the same topic of shopping, I wanted to get some opinions from you. When you're dealing with customers are they asking you where to go to get a loan, or do they generally have their own ideas about where to go to get a loan?

MR. WRIGHT: It's some of both. It asks for recommendations. But when it comes to shopping, I mean, I would agree with what Kate had to say. I think today's consumer, at least our consumer -- maybe Atlanta's consumer's are a lot more savvy than others, but are shopaholics when it comes to loan products. I mean, literally up until the day or two before closing, they're still, you know, on the internet, you know, calling around and such as that. So I think that this notion that they only go to one source and stick with whatever that source provides to them just doesn't hold true. I guess predominantly because of the internet, they're aware there's options out there and they shop them out.

I think that to your point, George, it would probably be helpful to the consumer and certainly it would be helpful for us as realtors helping the consumer is some sort of standardization across the disclosure so that there is -- you're really comparing apples to apples against product. I mean, sometimes that can be a little bit of a challenge to go through and try to really understand what one is disclosing and one is not. So I think a standard disclosure is something that we certainly would support.

MS. COHEN: Can I answer that? It may be that there are subsets of consumers -- large subsets of consumers who are shopping, particularly in association with purchasing a home. But in Atlanta, Bill Brennan and Karen Brown's office regularly sees people who did not shop at all. They didn't even know they wanted a loan, and the next thing they know they're losing their house. And so clearly, there's more than one thing happening in the market.

What we see around the country from not only legal services lawyers but also from pro bono lawyers and consumer advocates, consumer lawyers is that many, many people when they're refiing do not shop around. Frankly, most of my Harvard educated friends in Washington didn't shop around for a mortgage either. They went to their mortgage broker, and they took the loan that the person -- to their realtor and their mortgage broker told them -- you know, their realtor told them who to go to for a mortgage broker, and they just took whatever was given to them. And these are people who you would think would shop around for loans.

So I'm not sure that it's always true that people shop. But in the low and moderate income communities -- and by the way, the same laws apply to them as everyone else, and we need laws that protect them, as well as everyone else -- they are not shopping, and they are being sold loans that they don't understand. And if they do understand the disclosures that they're getting, they're not relevant to what happens at closing. And so part of what we see is someone is told orally or in writing your loan is going to be a fixed rate loan for 15 years or 30 years, and they show up at closing and they've got 228 ARM.

And so something needs to happen so that the early disclosure is accurate and relevant to what's happening to the borrower. But in addition, we can't assume that the disclosure is going to solve all the problems. Sandy, herself, described these transactions as extremely complex. Harry Dinham said we need training pre-hiring. And Mike Wright said, we have new products weekly. There is no way that the average person on the street, never mind all the people in this room, should be expected to shop around and understand new products weekly unless there's also an obligation on the part of the originator to do an evaluation for that person. May I say one more thing?

MS. BRAUNSTEIN: Of course.

MS. COHEN: I've heard from lawyers around the country that their clients don't get the CHARM booklet. I know Mike Bozeman's very proud of that book. He worked on it. I just want to say people aren't getting it. And I want to say that a lot people are not getting GFEs. They're not getting early PILA disclosures when they should. If it's not enforceable by a private cause of action, it often doesn't happen.

MR. FISHBEIN: Sandy, could I make a comment as well?

MS. BRAUNSTEIN: Sure.

MR. FISHBEIN: We've been looking at some of the internet information that's posted by lenders on non-traditional mortgages. I know you'll probably get into that this afternoon. But what -- And this is really in the wake. I know the guidance hasn't been adopted yet, but the wake of guidance being issued by the agencies instructing that there ought to be balanced information with clear portrayal of the risks involved in these products, and that didn't come across to us from many of these websites. Some had better information than others, I would certainly say.

But on the whole, they didn't convey a sense of risk for these particular kinds of products. They were more of option-oriented advertisements, and I think that in my mind shows a certain limit of best practices operating here in the marketplace and that if -- if lenders had more specific instruction or rules that were established about the nature of these advertisements, I think you'd see an improvement in the kind of information that's currently provided just across the board through the internet.

MR. CHANIN: Let me ask a question for Allen and Alys. Excuse me. Both of you mentioned that the board should exercise UDAP, unfair and deceptive authority. I assume you meant promulgate rules because the board does enforce that with respect to member banks and terms of examinations and like.

And my question is, there is obviously great difficulty in trying to construct rules that prohibit a practice and yet don't sweep too broadly and prohibit legitimate practices and that don't also end up doing nothing. But on the coverage of UDAP in terms of our rules, it's somewhat limited. That is, it only applies to depository institutions, banks, and even then, only some banks. It doesn't apply to thrifts. It applies to national banks and FDIC and Fed-examined banks. It doesn't apply to thrifts. It doesn't apply to secondary market: Fannie and Freddie, or any other secondary market entities. It also wouldn't apply to brokers. It wouldn't apply to non-depository institutions.

So my question is, given all that, I mean -- and there is no private right of action. So is it -- You know, is it of some value given those inherent limitations on our UDAP authority?

MR. FISHBEIN: Well, I would say yes, I think you correctly noted the limitations. And you know, other agencies like the OTS and the FTC could adopt their own practices, as well in this area -- excuse me, their own rules in this area, as well. But I think you laid out the limitations. But I think experience has shown in a number of areas of consumer regulation that in an agency like the Fed striking out and establishing certain standards as they apply to depository institutions would have influence over the rest of the market, and perhaps, bring other market practices along with the depository institutions.

MR. CHANIN: Alys, any -- You want to disagree with that one because I'm going to come back with a comment.

MS. COHEN: I want to agree with everything Allen said.

MR. CHANIN: I want to also, but.

MS. COHEN: I don't want you to sick your dog on me.

MR. CHANIN: I don't have a dog anymore.

MS. COHEN: The way I read 15 USC 1639 (l)(2), which of course, I have right here in this little book, it says the following: The board by regulation or order shall prohibit acts or practices in connection with (A) mortgage loans that the board finds to be unfair, deceptive, or designed to evade the provisions of this section, meaning HOEPA, I believe, and (B) refinancing of mortgage loans that the board finds to be associated with abusive lending practices or that otherwise are not in the interest of the borrower.

I took that to be something that you could do that could apply to all institutions and not only that would apply to a limited number. To the extent that you would do something that only applies to a limited number of institutions, the same way Fannie and Freddie said no more single premium credit insurance but it didn't apply to everyone, it had a huge affect on the market. But to the extent that you can have a change in the market for everyone, that would be greatly welcome.

MR. CHANIN: Okay. And there is for the audience, if you haven't fallen asleep already, there is an independent authority under HOEPA dealing with unfair and deceptive.

MS. COHEN: That's shorter than what I said. Thank you.

MR. CHANIN: Yeah. The follow up is, you know, if we were to use this authority under the general unfair and deceptive, you know, some of the issues identified by the prior panel seem to in other locations where we have had these hearings have identified not depository institutions but loan brokers or independent entities as the source, if you will, of some of these issues and problems. And so the question is, would we, in a sense, be effectively addressing something if, you know, we don't reach those players. You may have already answered that.

MR. FISHBEIN: You know, again, I think you're highlighting the limitation, and I want to kind of hedge my earlier comment in light of some, you know, additional examination of the scope of Fed authority in this area. But I do think that a statement by federal regulators that goes beyond saying we have a problem with certain practices are unfair and deceptive. You know, I think you're being bashful. I think we'll have a real impact on the industry across the board. Maybe the industry representatives might have a different view, but I think it would change practices.

MR. REYNOLDS: Can I make a comment? From a regulatory perspective, we -- in the examination process on the banking side, we have approximately 280 state chartered banks. And we routinely look at predatory lending practices as a part of our examination process on the banking side and quite frankly have not observed any practices that we would characterize as predatory, even though we look at it in the exam process, we look at the use of various predatory practices like pre-payment penalties, the use of unsuitability in terms of loan products, that type of thing.

We don't see that on the -- on the financial institution side. So I think you raise a legitimate question about whether or not you would be imposing a burden on institutions that, quite frankly, haven't demonstrated that they have issues in that area when probably the issue is more related to mortgage lenders and brokers than it is insured depository institutions.

MR. FISHBEIN: If I could just amplify for a second on what I said. I didn't address the point about mortgage brokers. And you know, clearly what I laid out is that I think there ought to be fiduciary like obligation for mortgage brokers to their borrowers, and that is an issue that needs to be dealt with directly. I have heard it say because the guidance did address the issue of oversight by lenders of their brokerage force that there's been considerable push back by the industry in the public comments that have been submitted.

And I think that just underscores this issue, that we have a major change in the marketplace from years ago when the -- the Reg Z disclosures were written, and we haven't developed a series of public policies and standards to catch up to those changes in the marketplace. And there's no more -- There's no area more obvious in our view than the brokerage channel and the role that they play in mortgage originations today.

MS. BRAUNSTEIN: Thank you.

MR. DUNCAN: If I could just -- While I'm not an attorney, so I don't know -- I have a worse liability. I'm an economist. I did want to say that there is -- there are some disciplines that are in place by market structure to prevent some of the problems. And those are that the secondary market assesses the relationship between achieved yield and expected yield, and the pricing on product that comes to the market where achieved yield is significantly less than expected yield flows back down to the origination.

Through the broker channel, the way that works is the lender who's the aggregator of broker business runs score cards on the brokers. And if the product that's causing them problems on the secondary market comes from specific brokers, they get cut out of the business through the score cards. Now, what does not happen is something, I think, it was Alys referred to earlier is that there's not a national registry of where the bad actors are. So they can leave the -- the business in one place and re-enter in another place.

And so that's a -- something that we care about and would like to see rectified so that it can improve the market. But it's not without disciplines. In addition to which, if a set of borrowers are being priced up through some mechanism, which is beyond the market assessment of risk, then what happens is prepays on those kinds of securities are much faster, and so that's another way in which the market will eventually drive that pricing down.

MS. BRAUNSTEIN: George, were you getting ready to --

MR. REYNOLDS: One issue that I was going to mention, the Conference of State Bank Supervisors is currently in the process of setting up a mortgage licensing process that we hope will add some uniformity and cut down on the situation of bad players leaving one market and entering into another. And so we have -- We're active supporters of that in this state and have provided support to get that underway. So we think that may address some of those issues.

MS. CRAWFORD: But at this time the group is only going to use the one -- for the registry the people that are already licensed in the states, if I'm correct on that. It's not -- And so it's not all originators. It's just who's licensed now. It's not mortgage bankers. It's not banks. It's not credit unions. It's not finance companies if they're not under the guidelines.

It's not everybody that takes a 1003, and that's what I think should happen. Everybody should be tracked, not just the mortgage broker or the mortgage banker. But anybody that handles that customer's application should be tracked because if they leave a mortgage broker and go to a credit union, they fall into the cracks because the credit union's not going to be in that registry or if they go through a national bank. And not all national banks check out their employees.

I know this for a fact for the people that work in my town. I mean, we wouldn't hire them, but they're hired by banks. So, it needs to -- That registry needs to have all originators in it, not just that segment of the industry. Please take that back to them.

MR. REYNOLDS: Well, I -- I appreciate that. I would point out, though, that the banking industry is probably the most -- one of the heaviest regulated industries in terms of the amount of supervision. You know, we have a very active examination program for our banks and credit unions in this state, and we go in most of them every year or every 18 months. And therefore, I would respectfully contend that they -- that the officers in those institutions are already very highly supervised.

MS. BRAUNSTEIN: Okay. Well, unless my co-panelists have any other questions, I think we're going to end this a few minutes early, and I want to thank our panelists today for a good discussion. Thank you all. We will now take a break for lunch for the hearing. We will reconvene at 1:30 with our third panel. Thank you.

(A short break was taken from 12:21 p.m. to 1:34 p.m.)

MS. BRAUNSTEIN: Welcome back to those who rejoined us, and we're going to get started with our third and last panel of the day. I just wanted to make a few reminder notes. I want to remind anybody who's interested in speaking at the open mike session to please sign up on the sign up sheet outside and to remind you that you will have three minutes for your presentation, but that you can submit longer written comments for the record.

And with that, we're going to start our third panel. We have -- By the way, Joan Buchanan has rejoined us, who's assistant VP from the Federal Reserve Bank of Atlanta and we're going to start our third panel. And the same rules as before, five minutes for your opening statements. Wayne's the time keeper. He will flash the yellow light when it's four minutes, and then the red light when your time is up. And with that, we can get started. Vanessa, do you want to lead us off, please?

MS. PERRY: Sure. Sure.

MS. BRAUNSTEIN: And start please by introducing yourself and your organization.

MS. PERRY: Okay. I'm Vanessa Gail Perry. I'm assistant professor at the George Washington University School of Business in Washington, D.C. And the purpose of my remarks are just to point out some issues that have arisen from decision research that relate to the redesign of disclosures, particularly from mortgage and other close end kinds of loans, specifically, what can we do to encourage consumers to attend to and elaborate on disclosure information.

There's some things we know about how consumers make financial decisions that would be helpful in this regard. For example, we know from research in consumer behavior that consumers are more likely to attend to and elaborate on a message such as a disclosure if they have the motivation, ability, and opportunity to do so.

First I'll talk about motivation. Consumers will be motivated to attend to and to process disclosure information if the information is personally relevant. That is, the information pertains to the specifics of their financial -- their financial situation. In addition, consumers will be motivated to utilize disclosure information if they perceive a high level of risk in the transaction. Consumers will perceive a higher degree of risk if the communication suggests that substantial financial, social, or other interests are at stake.

Another point related to consumer motivation is that paying off balances may not be a priority for consumers. Many consumers are short term oriented and are focused more on monthly payments than longer time horizons or accumulated balances over time. Thus, information about how much interest they will pay over years may not be considered important.

So how do we motivate consumers to use disclosure information? One way is to introduce disclosure information with personally relevant statements that communicate risk information. The statements that introduce the disclosure of specific terms may be as important as the terms themselves. For example, with this loan you will owe more than you do now, and you may face higher monthly payments as a sort of introductory statement.

Secondly, consumers will utilize disclosure information if they have the ability to do so. We know from recent research and financial literacy that we cannot assume that consumers have a thorough understanding of financial principles, such as APRs. In addition to limited financial knowledge, there are some common biases and decision making that affect the way consumers interpret disclosures.

First, consumers process price information relative to some point of reference. Thus, information about an APR of nine percent may be perceived as high or low depending on the rate the consumer uses as a basis of comparison. One such rate may be the prime rate, perhaps average rates or other comparisons could be disclosed in order to influence consumer perceptions.

Another bias that affects consumer decisions is that negative language carries more weight in risky decisions than positive or neutral language. So using the words cost or payments may be more effective than using more neutral terminology like rates and fees.

Finally, consumers will utilize disclosure information if they have ample opportunity to do so. This means consumers need enough time and attention to process the information, and the message must be at an appropriate level of complexity. In situations when consumers have low motivation, repetition is always -- is often used, which means actually repeating the same disclosure more than once. Another way to reduce complexity is to prevent consumers from having to do math. This creates a burden or possibly a barrier to interpreting disclosure information.

So in summary, I'm glad to see that understanding how consumers make financial decisions is a priority in the review of Reg Z, and I look forward to this discussion.

MS. BRAUNSTEIN: Wow. Thank you. That was great. We'll get back to some of those issues in the discussion. Okay. John?

MR. KOZUP: Good afternoon. My name is John Kozup, and I'm an assistant professor of marketing at Villanova University and director of Villanova University center for marketing and public policy research, an academic research institute examining a variety of marketing and public policy issues, including product labeling and disclosure, advertising testing and regulation, intellectual property and privacy concerns, signage and outdoor advertising, and a host of other areas. I appreciate the invitation to today's hearing on mandatory disclosure.

The primary focus of my research is in the area of product labeling and disclosure. Currently my colleagues, Elizabeth Crier and Michael Pagano and I are researching the effects of summary disclosures in the mutual fund market.

This is an extension of research that has been conducted in several other product context, including nutrition labeling both on food product packages and restaurant menus, dietary supplement labeling, claim and warning effects on consumer perceptions of alcoholic beverages, and the effects of on package graphics and health information on consumer perceptions of cigarettes.

Through this research I have found several commonalities that may aid in the refinement of truth and lending and RESPA disclosures. I will be basing my comments on prior results we have found across the previously mentioned product context.

My first recommendation is keep the disclosure short. Much of our work has examined the effectiveness of the nutrition facts panel in impacting consumer product perceptions and evaluation. Research conducted with my colleagues, Elizabeth Crier and Scott Burton, found that the nutrition facts panel, a summary of relevant nutritional data, does moderate the effects of product claims on several key dependent measures in both the package and the restaurant menu context.

Similarly, in a study of consumers in the mutual fund market a proposed one page summary prospectus highlighting performance risk and expense information interacted with fund performance to impact product attitudes, investment intentions, risk perceptions, and expectations of fund performance. Additional testing is underway to simplify the disclosure further to avoid issues of information overload on the part of consumers. Summary documents outlining key information and given to consumers prior to the legally required disclosures and potentially excessive paperwork associated with financial transactions would be a useful tool.

Second, educate then disclose. For any disclosure to be successful across the broadest possible consumer population, an education effort can and should be introduced prior to the introduction of disclosure information. Prior research we have conducted supports this recommendation. In a study of consumer's reactions to the new trans fat labeling requirements, we found that the addition of trans fat information on a nutrition facts panel only impacted product evaluations when consumers were exposed to an education piece, an article, prior to introduction of the disclosure. Consumers were either not aware of or did not attend to the new information provided about the food product without that -- without the education piece.

When informing consumers about products, it requires significant investment, such as purchasing a home or refinancing a mortgage. An education effort combined with relevant disclosure could yield a more knowledgeable consumer and is worthy of further investigation. From a managerial standpoint, consumer education can yield opportunities for those companies providing financial counseling through their trusted advisor role, potentially increasing customer loyalty while also serving the consumer's interest.

Third, use graphics to convey meaning where appropriate. In the previously mentioned mutual funds study, we experimentally tested a one-page prospectus with a graphic highlighting key performance risk and expense information versus a one-page prospectus that relied solely on verbal and numerical information. The findings for the graphical format were more robust.

Similarly, in a study conducted with Keys, Burton and Andrews, an on package cigarette warning that consisted of a graphic visual, in this case, a newborn with health problems, and health information in the form of a warning significantly reduced repeat purchase intentions for a sample female smokers. Graphics when properly utilized can increase consumers' attention and comprehension of product information.

In conclusion, keep it brief. Time your disclosure efforts after an education effort. Use graphics where appropriate. I would encourage testing each or all these ideas within the mortgage market with the broadest possible sample of consumers. I thank you for your invitation and your time.

MS. BRAUNSTEIN: Thank you. Pat?

MS. MCCOY: Yes. My name's Patricia McCoy. I'm a law professor at the University of Connecticut. Thank you for inviting me here to testify. In my remarks I will talk about the truth and lending act and whether it is really possible to comparison shop for mortgages in subprime market.

To evaluate that, we need to ask, how do consumers learn the price they will pay for credit. And in talking about price, I'm going to focus on nominal interest rates and APR. As it turns out, price revelation works very differently in the prime and subprime markets. That makes all the difference.

First, I'll start with the prime market. This is the market that TILA was designed for. In that market, lenders use average cost pricing and, as a result, prime mortgages with comparable terms carry roughly the same rates, not exactly but roughly. Consumers know that, and they will not deal with lenders who do not post interest rates. As a result, prime lenders post their interest rates up front and for free. This makes comparison shopping cheap and easy in the prime market.

In the -- In contrast, the subprime market is a pay to play market. Why is that? Under risk-based pricing, the lender cannot determine the actual price for the loan until the customer reveals information about his or her credit worthiness. As a result, at least today, the subprime market requires a customer to apply for a loan, pay an application fee, and go through underwriting in order to learn the price. Even then, often the true price is not revealed until closing.

For example, in actual cases that I've looked at, the prices on subprime loans often turned out to be a moving target. A lender or broker might have the customer apply for one type of loan, price A, say a fixed rate loan; changed the loan during underwriting to an adjustable rate mortgage, price B; and then finally change the loan at closing to something different at price C, say an interest only mortgage. Often, the effect is bait and switch.

Another problem is that subprime lenders treat their rate sheets as proprietary secrets and do not post them publicly. And I have an example on pages 2 to 6 of the handout. But this does not stop lenders from quoting their best prices in general advertisements, even if most of their subprime customers would not qualify for those prices. I have an example on pages 7 to 10.

For all of these reasons, meaningful comparison shopping is next to impossible in the subprime market. So how well do truth in lending act disclosures work for closed end mortgages and subprime? Unfortunately, despite all the best efforts of the board, they break down.

First of all, consumers cannot get firm price quotes before they apply. Technologically, that is possible today. A lender or broker could pull up the customer's credit score and locate where that puts the customer on the lender's rate sheet and give a quote that would be subject to verification of the information the customer provided. We should strive for that goal.

Secondly is the problem of general advertisements that offer the lender's best rate. Many of these ads are affirmatively misleading. They'll have a low teaser rate, very low, that is really a prime market teaser rate. And then, say, bad credit, no problem in the same ad. That lures people in. There will be no disclaimer that the interest rate could go up, according to your credit worthiness. This problem could be addressed either under HOEPA regulations, TILA regulations, or the board's authority over unfair and deceptive acts and practices.

Third is the moving target problem. With this, I recommend that final binding disclosures be made in writing to the consumer at least seven days before closing. And then finally, TILA disclosures for adjustable rate and alternative mortgages are needlessly complex. I have an example in the handout. And they do not provide the worst-case scenario.

Instead, we require borrowers to do the math with the $10,000 example in many cases. Unfortunately, many subprime borrowers are just like my law students. They can't do the math. And for these borrowers, we should provide a worst-case scenario with the actual number that is appropriate for the principal they're taking out. With that, my time is up. Thank you very much.

MS. BRAUNSTEIN: Thanks, Pat. Jan?

MS. PAPPALARDO: Good afternoon. I'm Jan Pappalardo. I'm an economist at the Federal Trade Commission. I'm delighted to be here today to participate in this important discussion about disclosures and mortgage choice.

I don't have a prepared statement. I'm mostly a researcher, so I'm going to go through a sort of PowerPoint presentation. The handouts are available. I hope that you have them.

Before I say anything, I should say that I have to give my official disclosure that the views projected here are those of the authors and not necessarily represent the views of the Federal Trade Commission or any individual commissioner. And this is joint work with my colleague, Jim Lacko.

Mandatory disclosures are everywhere. They're on appliances where you see energy labels, on food products, on prescription drugs, and on financial products. The potential benefits of mandatory disclosures are substantial. They can educate consumers and help to prevent deception, reduce search cost and facilitate comparison shopping, improve consumer decisions, and promote efficient markets.

But what I have learned in my 20 years at the FTC is that disclosure policy is tricky. There are many questions one must ask before starting a new disclosure policy. The first question, is the disclosure really needed? Will the information really improve consumer decisions? And another question that we fundamentally ask is why isn't the market voluntarily supplying the information if consumers value that information.

The second question, which is often more problematic than one could imagine, is whether there is a disclosure that's feasible. Is there a metric -- a single metric or a few simple metrics that really impart complicated information to consumers in an understandable way? Will disclosure work as intended? How will consumers actually understand and interpret a disclosure? How will it actually affect consumer decisions? Will it help some consumers but hurt others?

There are many disclosure pitfalls. You can supply irrelevant information, too much information causing information overload, inadvertently confusing information, and inadvertently misleading information. Potential costs of such mistakes are substantial. You can actually make information acquisition and processing more difficult and more time consuming for consumers. You can distort consumer decisions, impose unnecessary compliance costs, distort firm decisions on product feature offerings, and actually again inadvertently harm competition.

Consumer research is very important to assess proposed disclosures, to try to determine which are the helpful disclosures and which disclosures cause more harm than good. How do you go about doing such research? Well, it's important to examine the effect of disclosure on a sample of relevant consumers, not lawyers or economists. The second feature is to have controlled testing, to isolate the effect of the proposed disclosure compared to the right control condition, either no disclosure at all or perhaps an alternative disclosure that the marketplace is already providing. Research is also important to assess the actual impact of disclosures, perhaps looking pre and post the implementation of disclosure regime.

I'm going to talk to you a little bit today about a study that we did at the FTC, the FTC mortgage broker compensation study. I think the study illustrates that consumers can understand simple, clear, financial disclosures. That's the good news. Bad news is that it also shows that some disclosures can confuse consumers and actually inadvertently lead to worse decisions. Finally, back to the good news, I think it illustrates that consumer research can actually help to improve disclosure policy.

The studies that I'm going to talk about today is one that my colleague, Jim Lacko, and I did at the FTC. And we did it in response to a proposal by HUD for a new good faith estimate, which was proposed in 2002. And part of this would include a prominent disclosure of compensation paid to the broker by the lender, usually in the form of a yield spread premium. Direct lenders were going to be exempt from this requirement.

We had filed comments to HUD suggesting that we were concerned about this disclosure and that it might be unnecessarily confusing to consumers and result in worse loan choices. We did a controlled test in a setting where individuals looked at the particular loan document and two versions of the loan. And they were asked very specific questions about the mortgage, whether or not one cost less than the other and which loan they would choose if they were shopping for the mortgage.

Bottom line, the results indicated that we did worse with the yield spread premium disclosure than without it. Much worse than we had anticipated. The good news, however, was that without the yield spread premium disclosure, consumers about 90 percent were able to understand which loan cost less and would choose the less expensive loan if shopping for a mortgage. Thank you very much.

MS. BRAUNSTEIN: Thank you, Jan. And I know we're going to want to come back and talk more about that. Susan?

MS. KLEIMANN: Good afternoon. My name is Susan Kleimann, and I'm president of Kleimann Communication Group, a research firm that specializes in making official documents clear, accurate, and effective. My focus this afternoon is not going to be about creating a policy but on how to make the policy you develop meaningful for people.

Now, it may be a penetrating glimpse of the obvious, but most people do not deal with, encounter, and experience a policy in the abstract, not in the thought. But in fact, they experience it in a concrete, put-it-in-their-hand document, a good faith estimate, a privacy statement, or an enrollment application. So in terms of policy having an effect on the intended beneficiaries, the policy often is only as good as the document communicating it.

Now, a good policy document needs to have at least two qualities: clarity, as other people have spoken to, and transparency. Clarity so that the consumer does not misunderstand the information in the document, and transparency so that the document actually communicates neutrally. It must not direct an action, it must inform an action.

In order for a disclosure to inform clearly and transparently, consumers must be able to understand and integrate the disclosed information. When they don't, what happens is that the fundamental intent of the disclosure misses the mark. Now, the only way to tell if the document works is to test it, to have consumers work with it, use it, fill it out, and act upon it.

Consumer testing isn't about focus groups. It's about an intense and rigorous methodology in which consumers tell you when the document achieves both clarity and transparency. Let me tell you about a very specific instance to illustrate my point.

Jan has already started talking about it. When we were working on a formative redesign process for the HUD's good faith estimate, we introduced a number of items that research shows help consumers. We provided a context to help them understand the importance of the information. We provided a summary sheet to help them see the key information.

But we also had a striking aha moment that I don't believe ever would have surfaced without testing. A major policy objective of this redesign effort through HUD was to include a yield spread premium disclosure. The goal was to help consumers shop for the best value on a loan, which in most cases, would be the lowest cost loan.

Now, although the initial design of the new GFE seemed to be working well from our perspective, the study Jan is talking about in 2003 looked at this and really did find that there was a problem. Consumers were being confused. Consumers could identify the least expensive loan, but then they would often choose a different loan, often with a bias against the mortgage broker. Now, that was not the intent of the study. The study was intended to really help consumers shop for the best -- the best bargain.

When we went back -- Based on this we went back to redo a study and did a somewhat parallel study to what FTC had done, asking consumers what loan they chose and why they did it. And the results were astounding. In the original the line had said, bullet, lender payment to borrower for higher interest rate. And then there was a little block that allowed you to fill in what that payment would be.

When we asked consumers why they would choose a different loan, they'd see the cheapest but they'd choose differently, they'd go, well, on the front page it says that the rate is seven percent. This says for a higher rate. So they assumed in transferring that information that they weren't going to get the seven percent, they were going to get a higher percent. It was one of those moments in which we went, duh, how could we have missed this, how could we have missed it.

So we changed the language to say, you receive a credit of blank dollars for the interest rate of seven percent. This credit reduces your upfront charges. When we did that, the results were remarkable. They not only got to choose the correct loan about 90 percent of the time -- or identify which was cheaper, but they also chose the right loan at about the same percentage rate, whether it was a broker loan or a lender loan.

Testing can get you this kind of information. And often we confuse that the policy is wrong because, in fact, it's the disclosure that is messed up. We really advocate that you go back, test it with a consumer until you've got a disclosure that works, and then make your judgment about whether or not the policy is a good one or a bad one, an effective one, or an ineffective one. Thank you.

MS. BRAUNSTEIN: Thank you, Susan. Okay. I'm going to pose some questions. This is all very interesting. As I think everybody knows, we spend a lot of our life at the Federal Reserve writing disclosures. And you know, frankly, one of the problems we encounter is that any time a new product comes along or there's a new feature or something and there's concern about it, as there is now with the non-traditional mortgages and some other things, the first thing that we hear from not just the consumer advocates, but others and including people on Capitol Hill is, well, do we need a new disclosure about that.

And after a while, you know, one of the concerns that we have is you can only disclose so much and you get into this information overload kind of thing. And you keep piling on disclosure after disclosure, and yet people say you need the most information possible. And I guess the question I want to ask is, how do we weed through wanting to give people complete information about very complex products and at the same time not overload them to the point where it all becomes meaningless and nobody's getting what they need out of this?

And so, I will throw that open to whoever wants to. And I know, John, you had talked a lot about keep it short, keep it simple, keep it -- which is nice, except when you have a statute that requires you to disclosure 40 different things on a product. And so --

MR. KOZUP: You might be able to draw some parallels with the pharmaceutical labeling. There's a summary facts box now on prescription drugs with the pharmaceutical labels. What I'm arguing is, yes, there's a lot that you have to follow. You have to follow the letter of the law. But what I'm saying is there should be some sort of summarized component.

In addition to that -- You know, so the summarized component would focus on -- say, in the case of mutual funds, what's the key? It's not past performance. You have that little disclosure that says past performance, no guarantee of future returns, etc., etc. But what it is is the expense, so you need to prime people that this is the information. This is the salient information out of many of the things we're trying to communicate to you.

So, decide what's -- What are the key pieces of information? Come up with something in a very short, clear, concise format that you place front and center, and this gets into the issue of timing, when do you give them this. One of the things that I would argue is that when you do -- You know, you have to teach people to read disclosures. And that hasn't happened. People don't understand.

I was on the phone this morning with a member of my advisory board who runs a bank. He says, I've closed thousands of real estate loans. They don't read them. I cannot think of a handful of times when the customers came in with questions about it. He said, they trust me. That's it.

MS. BRAUNSTEIN: They just sign where he says sign?

MR. KOZUP: Uh-huh (affirmative). And he says, I tell them -- I tell them take -- at least take these -- take these papers, take them with you, read them. If you have any questions, come back. Where to sign? How do we make information that we feel is important? We prioritize information. How does that override the goals of the consumer who just want the loan, want the money, want the house, etc.? That's difficult.

But what I think -- What I would recommend is something right on the front that would (A) educate them and (B) train them how to navigate at least that particular piece of information in the disclosure.

MS. BUCHANAN: If I -- If I could follow up and just add on to that. One of our other struggles is it's not just disclosing 40 different issues associated with one reg. We also have four or five different lending regs where we must disclose those 40 pieces of information each.

So I think one of the struggles we have is an integration issue. There may be key pieces among each of those regs we would want to bring forward into a short, sweet, and perhaps somewhat negative disclosure. And what would be the best way to do that is integration and issue with all of the sensory overload we get with the one inch thick stack of disclosures.

MS. BRAUNSTEIN: Vanessa?

MS. PERRY: I just have sort of two recommendations just for follow up on both of those points. One is that, yeah, you can enhance people's processing -- the summarizing is definitely the key. But if you start out by sort of scaring them, that is, with some negative information and then you allow the consumer to control the flow of information, what you've done is give them the information and give them a reason to sort of take steps on their own to read the fine print or go to another part of the disclosure.

But to the extent that people don't feel that they need the information, they have no reason to sort of start off reading even the first bullet point in a disclosure. So maybe, you know -- I think that might be an approach to get people -- because there are always going to be 40 pieces of information, whether they're integrated or not. There's always going to be a lot contained in the disclosure. So motivating people to want to read through I think is a real important component.

MS. BRAUNSTEIN: And it is -- I found it real -- I found it very interesting in your remarks when you said the negative information is what gets their attention. I mean, on the one hand that seems kind of common sense. I guess on the other hand, I always wondered is it people -- it's like the worst-case scenario thing, that people think it'll never happen to them so they tend to blow it off. But you're saying, no, that doesn't happen.

MS. PERRY: The research shows and there's been a lot of work on this in a variety of arenas, particularly with respect to health claims, people will pay more -- they place more weight on negative information.

MS. BRAUNSTEIN: I guess because one of the things -- you mentioned health and what I was thinking of was when John talked about the pharmaceuticals.

MS. PERRY: Uh-huh (affirmative).

MS. BRAUNSTEIN: And you know how now you get these disclaimers right at the front that say if you take this drug, you know, it could make you, and it lists like 40 bad things that could happen to you if you take this drug --

MS. PERRY: Very, very bad things.

MS. BRAUNSTEIN: -- although they sound dire, but people still take the medication. And so that's why --

MS. PERRY: Well, the purpose is not to discourage them. The purpose is to get them to read further. So it's the same thing with health claims. Once -- They scare you by saying, you know, aspirin can cause all sorts of scary, horrendous things. It's not to discourage people from taking aspirin because once they keep reading they realize that the disclaimers really don't apply to them, but they would never know that if they didn't read it. And so it's the negative information that motivates people. It gets people engaged in finding further information.

MS. BRAUNSTEIN: That's a good point.

MR. KOZUP: Just to follow up on that very briefly. Our trans fat study was -- the article that we gave had negative information. I mean, it talked about the risk of trans fat, coronary heart disease, and things that are associated with it, and that's when we got effects. So without it, people didn't attend to that information.

MS. MCCOY: It seems to me that this is where timing can be very helpful because I would assume the 40 disclosures don't necessarily all have to be made at the same time and so, for example, if -- let's say seven days before closing, you had a very simple disclosure that is the Schumer Box plus maybe the worst-case scenario for variable rate loans. And it's -- It's all by itself. It's not with a whole stack of loan contracts, etc.

And that gives a cooling off period for the person to think about the disclosure as well. So timing can be helpful. Also with general advertising, we may be less concerned with exactly what you will get as opposed to what you won't get.

MS. BRAUNSTEIN: No. That's a good point, and timing is something that I did want to discuss. And I know you talked about the content, but not really about the timing. The mortgage process can go over -- depending, some people get them in close very quickly. Other people it can go over some period of time. And I wonder about the timing of disclosures and the retention of that information and if you get disclosures when you apply for a mortgage, do you remember them two months later when you go to closing kind of thing. Do you -- Have you ever done any studies, either of you on that or do you have opinions about that?

MR. KOZUP: I used to close loans. I mean, I ran a branch for a mortgage company and to consumers we would send things out within three days of application. Consumers remember vaguely getting something in the mail. You know, and then what you would have to do you would have to --

MS. BRAUNSTEIN: Educate them.

MR. KOZUP: -- basically re-educate them at close.

MS. KLEIMANN: But I think that part of this is what John had talked about before is there's an issue of salience that when you are given an inch thick document it doesn't matter when the timing is. The effort that it requires us as well educated, competent people to go through that kind of a document and then retain much of it five minutes, you know, it is really -- it's quite a level of effort of cognitive processing. So part of what -- when we think about timing, we also really do have to think about how do we give salience for the consumer. That's how we help the consumer.

And whether it's motivation and it's fear or what, again, a little bit of my hobby horse, but if you test with consumers, they're going to tell you what's salient. They're going to say, oh, it bothers me that banks share my Social Security number. That's part of the way you can pull them into the document.

But you're not really going to be able to figure that out without talking to the consumers, and then, again, sorting the information so you're not trying to give them everything. You're helping them be able to know what are the key documents. Like John said, summary documents really can be very helpful that way, but not a summary document on a stack like this is five pages long. That's not a summary document for many consumers.

MR. KOZUP: One page was too much in the mutual fund study we had. We had overload with one page. So --

MS. BRAUNSTEIN: And how do you know you had overload? People said it's too much for me to digest or --

MR. KOZUP: Well, we didn't get -- What we got, we got interaction effects. We didn't get main effects for the actual disclosure. So what we've got to do, we have to keep it even simpler. And we used a -- Even in the situation with the graphic, one of the things with the graphic -- and this gets into perceived credibility if you were to go the graphical route -- we also measured perceived information amount, along with attitudinal variables and things.

Consumers did not -- I mean, they liked it. They gravitated to that graphical piece, but they didn't believe it was enough. So if you did something, you'd have to do almost a one, two punch. If you used a graphic, maybe put that front and center, and then have the supplemental --

MS. BRAUNSTEIN: And explain it.

MR. KOZUP: -- information from a legitimacy perspective.

MS. BRAUNSTEIN: I want to come back to one thing and then I'll give you guys a chance to ask questions. But I do want to come back over here to Susan and Jan for a second. On your specific example about the GFE, interesting because it's obviously quite relevant to what we've been discussing in all these hearings.

One of the things we've heard over and over again from the consumer groups is that we should add, you know, disclosures on yield spread premiums and that that's a really important piece. And I guess I'm still not exactly clear. What was it the consumers didn't understand about the YSPs? What was the problem?

MS. PAPPALARDO: In our study I can't tell you what it was that they didn't understand. What I can tell you is that they did worse with the YSP disclosure than without the YSP disclosure.

In the back of the study we do have responses to open ended questions. You can kind of peruse through. You can see what some of the open ended comments were. It's a story to be told there, but it's not scientific in the sense of testing a specific hypothesis.

What we can say is that both in the situation where they had identical cost loans and where one loan cost less than another loan, they did worse in terms of identifying the true cost of the loan and there was a bias in terms of which loans they would choose if they were choosing to a particular loan. And they would choose in our study with the examples that we used the direct lender loan where the yield spread premium was not disclosed as opposed to the more so than the mortgage broker loan.

MS. KLEIMANN: If I can -- Jan and FTC did their study. And then based on the results that they were getting, HUD came back to us and asked us to do some modification for the notice to the good faith estimate. And what we were seeing was it was the use of that phrase higher rate that they were just making the assumption. It's what you want consumers to do, carry a piece of information from page 1 onto to page 2 and integrate it.

Unfortunately, they were integrating poorly. And with that change of language, and we tested both the yield spread premium being revealed and then also when we're -- there was a little check box that said our cost is rolled up into the previous number that you see, consumers really did perform comparably. So if it was a different loan, they could identify the lowest loan and they could choose -- they could say this would be the loan I would choose.

So it was very close. I mean, maybe 97 percent were choosing correctly, but about 88 percent -- I'm sorry -- 97 percent were identifying correctly, and then about 87, 88, 89 percent right in there also chose correctly with the assumption that choosing the lower cost loan would be right.

And I think that it does -- Again, it speaks to the importance of having these kinds of research questions. Without the study that FTC had done, I don't think -- I know we would not have gone back and made those changes and tried to document that in fact it was working.

Now, is there more research we could do? Absolutely on it. But this is one of those places where very specific information, language on this. It wasn't the policy. It was the language that made a difference.

MR. MICHAELS: I want to follow that up a little bit because this morning I heard two different representatives from the mortgage brokers trade association talk about taking the good faith estimate and making it look more like a HUD-1, which to me makes it sound like it's going to be more detailed and more complex. And I thought there was some consensus about making the GFE simpler and less complex.

MS. KLEIMANN: Right.

MR. MICHAELS: And so -- You can see where I'm going with this. And so, my question is going to be, when you're talking about something like a yield spread premium, which seems to me an inherently complex concept to ask consumers to understand, you know, are we really talking about making the consumer disclosures more understandable, or, you know, do consumers need that level of information? Are they looking to comparison shop based on, you know, the bottom line cost, which can be fairly simple, or do they really need to have it broken down with that level of specificity at the good faith estimate?

MS. KLEIMANN: Now you're asking me to talk outside my area of expertise, and I guess I need my disclaimer, which is I'm not talking for HUD. I'm talking in terms of language. I don't know the answer to your question. I think that is the fair thing to say.

I think what we could see is that it didn't affect performance on the study. Now, the question of should it be there or shouldn't it be there, do they need it or don't they need it, that's really a policy question. What we're trying to do is if this is the policy and you want to show it, then please show it correctly.

And just to kind of pick up on something else you said, no, the good faith estimate should not look like the HUD-1. The HUD-1 needs to be cleaned up. That document is a disaster. And so, consumers -- Oh, sorry. Consumers can't really can't --

MS. BRAUNSTEIN: Is there anybody here from HUD?

MS. KLEIMANN: Consumers can't process that information. I don't know that the HUD people would disagree with that. I mean, it's really -- It's a very complicated document, very difficult to process. And at this point, the good faith estimate actually bears little resemblance to it, and it should.

MS. MCCOY: Jim, a couple of points just to think about in terms of this -- what I think is a difficult issue with YSPs. One is in situations in which the YSP resulted in a higher nominal interest rate than the one the lender otherwise was willing to accept, that to me is the economic effect that's pernicious and that a consumer want to know. Right now, the YSP disclosure does not reveal that interaction between the YSP and the nominal interest rate.

The other thing is, speaking for the legal vantage, is that -- that YSP disclosures are useful in documenting what happened in the transaction and the dynamics if later there's a problem. And I certainly know when I've been asked as an expert to look at predatory lending cases and I can actually see the moving target problem where the YSP negotiations going on behind the scene ended up in a really significantly higher interest rate. It's very useful to be able to testify about that, and the disclosure gives me the ability to connect the dots.

MR. MICHAELS: You took that in the direction I wanted it to go, so I thank you. Because I think one of the things I wanted to ask is you're here talking about, you know, what is effective consumer disclosure. And I think there's a school of thought that says, you know, sometimes the disclosures aren't there merely to inform and educate the consumer. The disclosures are to bring some discipline to the transaction to create some transparency, which effects the way the industry prices the products and sells the products. And so the question is: To what extent is that a legitimate school of thought or do we need to focus more on disclosures as just information for the consumers and not try to make them do double duty in terms of trying to hold the industry to a different standard on how it operates?

MS. MCCOY: It is a good question. There's attention there, obviously, if we're trying to simplify disclosures. I think the way that I would probably mediate that one is to have, again, a simpler disclosure before the closing that's separate. But go ahead and have documentation of the YSP at the closing so that it would be in the loan documents.

MS. BRAUNSTEIN: Do you -- I'm back kind of at this end of the table, although you guys are welcome to jump in, too. I know you're doing -- Maybe in the kind of research you do this isn't relevant. But one of the -- the things that we always face in terms of designing disclosures is that we also hear from the industry side, who has to give the disclosures, and we hear a lot about burden.

And one of the things that struck me along those lines was something -- excuse me -- that Vanessa said in her opening remarks about the importance of it being personally relevant. And I think that -- I mean, for one thing, that's kind of to me common sense, but that's a lot -- it's going to mean a lot more to me in a disclosure if it's relevant, if it's transaction specific to what I'm doing as opposed to some generic kind of information.

But then we hear from the industry that making those kinds of disclosures transaction specific, you know, is a huge burden for them to do. And I was just wondering if you have any comments about that or if you've encountered that in -- when you've done research, that issue.

MS. PERRY: I certainly haven't even thought about that, except that, I think, actually in the earlier panel somebody was talking about -- there was sort of a discussion about sort of hypothetical situations being used. And I think that's fine because the purpose is not necessarily to communicate specific information. It is to motivate the consumer to seek specific information.

So there's nothing -- So when you look at it that way, the disclosure itself doesn't necessarily have to be finely tuned to the specifics of a particular loan transaction. It just has to be close enough that it resembles something that will resonate with the consumer so that the consumer will, again, read the fine print.

MS. BRAUNSTEIN: Except that you also said don't make them do math. And that's what we're talking about in some of these is that it's a generic kind of disclosure that would cause somebody to have to do math to get to their specific transaction.

MS. PERRY: I just have to share this study I found. It was posed by Associated Press. A recent study found that more than 50 percent of students at four-year schools -- these are colleges and universities -- and more than 75 percent at two-year colleges lack the skills to compare credit card offers with different interest rates and annual fees. And I bring that up just to say, we cannot ask people to do math.

MS. BRAUNSTEIN: But to me --

MS. PERRY: Even, you know, educated ones.

MS. BRAUNSTEIN: -- that kind of violates what you initially said to motivate them to look further because in some cases, looking further means having to do math --

MS. PERRY: Well, yeah, but --

MS. BRAUNSTEIN: -- and other kinds of things.

MS. PERRY: -- you could do that with an estimated monthly payment or an estimated payment increase or something like that. It doesn't necessarily have to be a sophisticated computation, just something -- enough to cause the person to take a second look. That's all.

MS. MCCOY: Sandy?

MS. BRAUNSTEIN: Yeah.

MS. MCCOY: If I could play out your question in the context of a possible worst-case payment disclosure. I've recently been studying automated systems. And there are all sorts of automated systems that lenders can use and do use to automatically compute the APRs, finance charges, etc. Those can be easily programmed to compute an actual worst-case monthly payment scenario for resets.

Because people focus on monthly payments, that probably would be highly salient to them. And it seems to me that you might have -- The way that you could structure it is that you give the maximum reset for every contractual reset date up to the cap in the loan because all these loans have caps about how far the adjustable rate can go. And do it according to the amortization schedule. So all of that is -- is already laid out in the loan terms and that can just be quantified, programmed, put into the computer program and printed out just the way the APR's calculated.

MR. KOZUP: I just wanted to add a couple things. First of all, with this whole idea of disclosure, it's a segmentation issue in the fact that, you know, one size can't fit everybody with these disclosures. And when you look at it, people can't do math. I think the conclusion of this, people can't do math.

What companies have done and when I talk to folks about disclosure from a lot of organizations, they talk about the Web. We've got this great interactive program. Our consumers can go to our website. Does that help people in the subprime market, you know, the traditional client base in the subprime?

In 30, 40 years, we might not have to have this discussion anymore because our kids know a heck of a lot more about computers than we do, and they're looking to the Web for everything. But you're looking at basically a tiered populous right now. So how do you manage that? Do you give some general guiding principles to companies based on the segmentation, who they consider their core clients and then let them run with it? I don't know.

But looking at it -- And the companies have the data. They know their customers. Maybe the disclosure construction could work on an interactive basis for those. And maybe prime markets have a more fluent customer base, more educated, younger, etc. But in other situations, there's going to be print and maybe you also have to throw in the additional counseling and education efforts on top of it.

But that might be a way -- Does it seem more burdensome if you gave enough leeway to the companies to do this? Not necessarily, came up with some guiding principles on how they feel they can most effectively reach their customers. Just a thought.

MR. CHANIN: Let me turn back to this issue of timing, and let's take a simple scenario, which obviously is not going to be true but just for purposes of kind of focusing in on timing. Let's assume you could have the exact same information, and let's say it's fairly specific. And during the mortgage process there's given the time frame that could be given early or later, for example, a few days after application, some point later than that, or close to the closing. Which of those time frames -- If you can answer this, which of those time frames works best in terms of consumers looking at the information, either using it to shop or using it to better understand their products, everything else being equal, that is, the format, the content, the little language used, and so forth?

MR. KOZUP: That's tough. Earlier in the process, yeah, it's potentially better. But then, see, I have a problem with this one because we talk about giving disclosure. And I know you're worried about cost, application fees, etc. I'm worried about people pulling bureaus. If the consumer's comparison shopping and you're pulling multiple bureaus, their score's going to take a hit.

So you know, but then there's a level of specificity in terms of the risk pricing and some of the other things with the loans. How specific can you get up front? It depends on what you're going to give the consumer. I would argue that if you can do something up front, you know, and maybe not with the level of specificity, but just to engage them in the process of acquiring information. Forget the disclosure. Get them -- Get them thinking about this process and maybe then when they have the disclosures, they'll attend to those key pieces of information better.

MR. CHANIN: Any other thoughts?

MS. MCCOY: Yeah. The -- I agree that if you're going to do meaningful comparison shopping, you have to have the shopping information before you actually pay an application fee. That's the sort of meaningful time to be doing -- comparison shopping before you've written a check for $300 or whatever. And then the issue is do you have some sense that you're giving the right number, that it's a firm or semi-firm quote if you, as the consumer, have given truthful information?

And those -- Right now in subprime, those are real challenges. I don't think they're insuperable. But if we can -- if we can accomplish that, it would be to me the Holy Grail.

MR. CHANIN: And let me follow up on that because, obviously, the earlier you go in the process the less likely the information's going to be correct or, at least, perfect. Is there a risk -- Let's assume it's not literally on the Web page, which is not going to be very specific in terms of your particulars. But let's assume it's a few days after application, is there a risk if you give that information and it's not going to be perfect that the consumer reads that and then is alienated? That is, that they see that information and then a few weeks into the process they call the lender and find out things have been changed, is it worse to get that information early and not have it be as accurate than not to get it at all?

MR. KOZUP: Ask easier questions.

MR. CHANIN: All right. That'll be my last question.

MR. KOZUP: The only thing I would say to this, it depends on what you give them. I mean, really we don't have to give specific disclosures up front. I'm saying, take them through a process and educate them up front. There should be some other document, you know, that's a bit more general in nature. And then have them attend to the consumers -- attend to the information throughout.

The other thing I ask, we don't know how much sticks. We just -- We had a little note discussion. How much memory testing's been done on the existing disclosures? Have we run a 15-minute distracter test and measured their knowledge afterwards? Have we run a one-day, a three-day, a five-day? We don't know. And until we know that and we know what key pieces of information are actually sticking over time, we can't make -- judge it.

MS. BRAUNSTEIN: Jan --

MS. PAPPALARDO: I tell you, I came to working in this area after working in health claims for many years. When I was first asked to look at the mortgage area, the thing that struck me is that there's very little publicly available research on the role of disclosures in the consumer shopping process and how consumers make financial decisions.

And I think it'd be great if more researchers are involved in this area. I don't know why it seems to be so under studied. But for such a big budget, big ticket, important item, it's remarkably under studied. And to just bring more research like what Susan's been working on, more controlled testing research to the table is just a great contribution for any researchers out there.

MS. BRAUNSTEIN: Amen. Jim, you had some questions.

MR. MICHAELS: First of all, I feel like I cut you off before when I was talking about how much detail consumers need in terms of their shopping. Was there some other point you wanted to make?

MS. PAPPALARDO: Well, I would just say, again, these are all testable things. You know, we're trying to do some research at the FTC, more on about how consumers search for mortgages and look more big picture. I think that this is one of those areas, again, very much like health claims was maybe 15 years ago where it's time for people to step back and basically put on their thinking caps and say if you were shopping for a mortgage and we didn't have the regulatory world that we have with competing regulations, let's go back to first principles, what is it that consumers need to know and can we develop a form and test it.

I think that's really where we need to begin. And I would -- Also, I'd hearken back to this lovely 1998, I believe it is, the HUD Fed report, which is a wonderful report if you haven't seen it, that talks about disclosure issues and it's a great reference point and a starting place for anybody who wants to work in the area.

MR. CHANIN: Jim told you to say that; didn't he?

MS. PAPPALARDO: No, he didn't.

MS. BRAUNSTEIN: He had a lot to do with writing that report.

MS. PAPPALARDO: I have two copies.

MR. MICHAELS: I have more than that. Let me come back to another point Vanessa raised about having an attention grabbing disclosure or something that grabs people's attention up front. And I asked this question this morning, so I wanted to repeat it this afternoon. There's been talk about, you know, giving consumers information about the worst-case payment scenarios and, particularly, with respect to non-traditional mortgages, if not ARMs generally.

My question would be is that an example of a sort of a attention grabbing disclosure in and of itself or is that something that consumers can actually evaluate? Does that give them cost information they can actually use in terms of being able to relate, you know, information that may be relevant five years, seven years, ten years down the road or is that just merely a sort of a scare tactic and attention grabber?

MS. MCCOY: Well, at this point it's neither because the disclosures at closing, it's buried in all of the rest of the closing documents, and it's either a hypothetical -- the $10,000 hypothetical, the house of my dreams, or it's this historical set of -- of interest rate movements. And so right now, it's not being absorbed at all.

MR. MICHAELS: But I guess my question is, if you're -- if you give consumers up front information about what's the worst thing that might happen to you five, seven, or ten years from now, can they actually relate to and use that information or do they just not have the ability to because you're talking about a hypothetical world where other variables change, not just the amount you might have to pay?

MS. MCCOY: I think I'd echo Jan and say we need to test that. But we really -- We really do need to test it. It's such an important thing because it's the reset shock that for many people puts them into default, so the stakes are high.

MS. PERRY: I think that I -- First of all, I'm a big fan of testing. I think everything needs to be tested so there's -- everything related to disclosures. So that's definitely the case. But in theory, a worst-case scenario estimate serves as a reference point -- a point of reference. It gives people a basis of comparison.

And so, you know, again, it doesn't necessarily have to be perfect. But it can shock, if you will, a consumer into paying more attention to additional disclosure information. And so it serves that kind of purpose, as well, even if it's not perfectly accurate or perfectly reflective of their situation or the future.

MR. KOZUP: I would only add one thing. I think testing's a great idea on this. I wonder how it's going to impact comparison shopping. I really wonder how it would impact comparison shopping when you have this negative reference point that's just screaming, oh, I could lose my -- you know, however you frame it.

So that's -- Definitely test one would be quite interesting and layering some scenarios on top of those types of things, too, in terms of different -- consumers' different goals and seeing how those interact. That could make for some very interesting research questions.

MS. KLEIMANN: Well, I think there's another issue that's going on here. There's a difference between an expert user and a less expert user. And one of the big differences that we see just across any field, especially composition processing is that expert users often have very well developed frames that they can dip into and are able to see implication. So they can take an abstract and make it very concrete.

One of the things that these kinds of scenarios can do for a consumer -- and again, I'm not advocating using a worst case -- but part of what you're trying to do is take a user who is not necessarily an expert user for any variety of reasons. And those types of scenarios can give them a way of seeing the abstract made concrete and seeing implication. And that's one of the problems we have with people who just aren't as expert.

And again, I'm not talking about an education level or a literacy level. That's true for any of us. You know, put me into a room of physicists and I'm not going to be an expert user. So, you know, that idea of making it concrete, whether it's highly negative or just very concrete, I think, is an important piece that we would want to consider.

But again, I'm going to echo Jan. Don't do this without testing it. I mean, you've got to see what happens when consumers encounter this. I mean, what I'm talking about is, in fact, an abstract. It's an abstract principle that we know is true, but we've got to see how it works in the concrete.

MR. CHANIN: Let me talk about something I think Jim eluded to -- excuse me -- in a slightly different way.

Part of the function or maybe the primary function of these disclosures is shopping, though there's an education component. And we know there's a trade off and some tension in terms of getting information out early to consumers to allow them to shop because there's some question about how specific that can be.

But the question is: Should we focus as much on repetition, and not repetition of disclosures but of consumer behavior? For example, the first time a consumer buys a home, he or she is going to get lots of information today. Hopefully that's going to be improved in the future. Maybe it'll come early on in the process.

But will the consumer, if we do this right, is there the possibility that the consumer may or may not use this to shop for his or her first loan, but should we keep our eye on future behavior? And that is, say, the consumer's now going to know, they're going to get this information sometime after they apply -- three days after they apply. So in the future, they are more likely to use this and understand that process. Is there any research on that if you understand where I'm getting at in terms of focusing not on using it for shopping at the onset, but rather as a behavior changing mechanism, I guess?

MS. BRAUNSTEIN: We got silence.

MS. PERRY: That's a difficult -- Your question really relates to sort of cumulative effects of --

MR. CHANIN: Right. Exactly.

MS. PERRY: -- learning and --

MS. CHANIN: And is there that and can we hope that occurs by focusing people at an early time?

MS. PERRY: That's hard. I know I just recently read a study sponsored by Bankrate that showed that mortgage customers -- nearly a third of existing mortgage customers failed sort of a test of basic financial principles that you would expect them to be able to pass given their experience with mortgages. I'm not sure, but one implication may be that this kind of information just doesn't stick because you don't get mortgages -- you don't go through this process all that terribly often.

So now I have to say this before I say everything, this is something that needs to be tested. But you know, who knows? It may be the case that there's just too much of -- it's too stressful and there's too much of a span of time between these kinds of transactions for people to really carry any learning over. You know, who knows?

MR. KOZUP: And plus, what's the consumer's preferred method of acquiring knowledge? I mean, you might be doing repetition effects with print, and it's not going to take because they're Web based or they developed those skills or techniques over time.

MS. MCCOY: A couple of other thoughts. Sometimes while you may learn about the transaction, the next time you do it, if you can't get the information you'd really like up front, then -- then you're -- you've been educated, but you still can't use it. And the other thing, I went for ten years between applying for mortgages. And in that time period, the market had changed from manual underwriting to automated underwriting. And I barely recognized the process the last time I did it. So the process may itself change.

MR. CHANIN: So it sounds like that our focus, at least without some further evidence, may not be on this long term cumulative effect, at least in mortgages. Now, maybe in credit cards or other products there's more usability in that context.

MR. KOZUP: Usability, though, with a disclosure that's a six point font, and a lot of the statements and other things. I mean, we've -- Susan, go ahead. This is your --

MS. KLEIMANN: No, that's okay. I mean, I absolutely -- Again, you've got to look at how usable that document is --

MR. KOZUP: Right.

MS. KLEIMANN: -- and whether consumers can just process it, not just from the content, but process it linguistically, process it in terms of its organization, process it in terms of its queues. And sometimes it is as basic as a six point font. Nobody's processing that, including us -- including us.

MR. MICHAELS: All right. So you take the entire discussion we've had here this afternoon. And now let's --

MR. CHANIN: Don't go there, Jim.

MR. MICHAELS: And let's apply -- Let's apply it to the electronic environment. I guess my basic question is: Is have there been sufficient studies or is there research that gives us some sort of broader lessons to be learned about the electronic environment and how -- you know, how the disclosures are effective in that environment that may be different from the paper environment?

MR. KOZUP: I'm not familiar with it.

MS. KLEIMANN: I don't know that there is stuff about disclosures. There certainly is a field of emerging evidence and research that talks about how people encounter the Web, what works, what doesn't work, the idea of how much information can you put on a page. I mean, that type of information is certainly out there, and there's not time to go through a whole long list of that.

But I think some of the same principles that we've been talking about here are still going to be valid principles when you go to the Web. Obviously there is a richness that the Web can give you in that you can chunk and layer information in a way that you can't do that in a paper document. And at the same time, one of the problems with Web documents is you never know how big it is, so you don't know how you're getting to the end and when you get to the end. So you can still be lost in cyberspace. And this whole idea of consumers needing to be able to relate the idea of the whole and the part and understanding that relationship is really a very critical aspect of being able to learn, retain, and apply.

MR. CHANIN: Can -- Let me follow up on something Pat said and mentioned about paying an application fee and how at that point -- I'm not sure your exact wording, but that's -- the consumer is committed. Do we have any information on shopping and use of information and what point is, in a sense, too late? That is, if the consumer pays a fee, have they completed their shopping or is that not the case? Does it matter if the fee is refundable or not or is the simple payment of a fee application for appraisal, so forth? Any information on that? None? Okay.

MS. BRAUNSTEIN: Okay. Do we have any other questions, panelists, or anything else anybody would like to say on the panel? All right. I'd like to thank you all very, very much. This was very interesting and quite relevant, since, like I say, some of us spend a large part of our lives writing disclosures, so this was quite helpful. I want to thank you.

We will end this panel now. We will take a break until 3:00, at which point the sign up sheet is cut off and we will start the open mike sessions.

(A short break was taken from 2:46 p.m. to 3:04 p.m.)

MS. BRAUNSTEIN: We're going to get started. Could I have your attention please? Okay. I want to call some names and ask people to come to the front and sit -- fill in some chairs. If Senator Vincent Fort is here, please come forward. And you can take, like, the first chair on the end there.

SENATOR FORT: The first chair?

MS. BRAUNSTEIN: Yeah, because we're going to start that way. Karen Brown. Is Karen Brown here?

MS. BROWN: Yeah, I'm here.

MS. BRAUNSTEIN: Okay. Adrienne Ashby.

MS. ASHBY: Right here. My client is with me.

MS. BRAUNSTEIN: Okay. You can both come up. Okay. Nancy MacLeod. Okay. And that will be it for now, and then we'll call more names up. Okay. Senator Fort -- Well, before you start, let me just restate the rules for everybody.

You have three minutes for your statement. Our time keeper, Wayne, will flash a yellow light after two minutes and then the red light when your three minutes are up. You are welcome to submit written statements of any length for the record. But you have three minutes for your verbal -- for your oral statements. Senator Fort, would you like to start?

SENATOR FORT: Thank you, madam.

MS. BRAUNSTEIN: And please start by -- by the way, introducing yourself and if you represent an organization for the record because we have a court reporter.

SENATOR FORT: Thank you. Thank you, Madam Chair. My name is Vincent Fort. I serve in the State Senate, 39th Senatorial District which goes from the south side of the metropolitan area all the way up through -- as a matter of fact, you're sitting in the 39th District now. It goes all the way up to Buckhead. And one of my constituents, who was a victim of a predatory loan, was supposed to be here. And she is, I think, running late, and maybe we can introduce her at another time in a little bit when she gets here.

But what I want to say today right now, I understand that the activity of the consumer advocates on predatory lending here in Georgia has come under some question today, this morning. Some people saying that the Georgia law passed in 2002 was a bad law. I beg to differ. It is just the kind of law that is needed to stop predatory lending here in Georgia. It is a -- It was a law that should have been replicated throughout the country. So any insinuation that that law was a bad law is wrong.

And the -- Any other insinuation that it drove lenders out of Georgia is also wrong. That's not true. The law took effect in October of 2002, and the predatory lenders went to work in January 2003 to gut that law. They did it with a campaign -- a fair, a coordinated campaign that went all the way up to Standard and Poor's and played point on that issue for them. And I have a letter that I wrote to Standard and Poor's January 28th, 2003, that I'll submit into the record, ma'am, when the -- when my remarks are finished. But I wanted to defend what I did and what consumer advocates did from 2000 -- from April of 2000 to the passage of that law in March of 2002.

What needs to happen is that the abuses, and I hope that Bill Brennan will share with you a list of the abuses that he and Karen Brown have developed over the years. What needs to happen is that the abuses -- the predatory lending abuses need to be made illegal for all loans. We have gone down the avenue of tweaking the triggers and all of that kind of stuff. But at this point, we need to have -- we need to walk down a new avenue, go in a new direction, though all of the abuses -- all of these bad practices need to be made illegal.

And to be honest with you, I don't know if it's something that needs to be done on the federal level. The NAY (phonetic) bill that is in congress now is a bad law. It would codify predatory lending. It's a bad bill. I hope it doesn't go forward, and I would publicly ask my good friend, David Scott -- Representative Scott in congress to withdraw his support from that bill. It's a bad bill, and it ought not to go forward. If necessary, we need to work on the state level to pass good predatory lending laws.

Two, I think we need to make sure that there's full assignee liability on these loans, full assignee liability. We are in the -- It's almost as if we are chasing shadows. When these loans are sold, chock full of abuses, it's like chasing a shadow, not being able to find -- not being able to hold accountable the people who own these predatory loans.

And as I close, Madam Chair, let me say this: We would hope that the Federal Reserve would not only pass regulations but would use its bully pulpit in Congress -- with Congress to pass, if there is a federal law passed that it be a strong federal law, that it not be a law that will allow my constituents who I hear from every day, that it would allow a strong predatory lending law to pass on the federal level if that's the case. Hopefully it won't be the version that's being discussed currently. Thank you.

MS. BRAUNSTEIN: Thank you very much. Ms. Brown?

MS. BROWN: Thank you. My name is Karen Brown. I'm a staff attorney at the Home Defense Program of the Atlanta Legal Aid Society. I want to tell you about one of my clients, who's sitting here with me today, Ms. Eloise Manuel. Ms. Manuel is 66 years old. She's African-American. She's lived in her home in DeKalb County, Georgia, for 33 years.

Until she retired four years ago, Ms. Manuel worked primarily in food service, preparing salads and working as a line server. Other jobs she held included making picture frames and cleaning office buildings. In 2000 Ms. Manuel paid off her original purchase money mortgage. Her home was free and clear.

A few years later, she decided to apply for a mortgage loan to pay her bills. When she made her application, the mortgage broker pulled her credit and found that her FICO credit score was 703. The broker was surprised, but she wasn't because she knew she had always paid her bills on time.

Ms. Manuel told them, I need a payment I can afford, and I want a fixed interest rate. She told them she was on Social Security and received only $541 a month. They told her she was getting the lowest interest rate and that her monthly payments would be $120.

So what loan did she get? Well, this loan was a HELOC, a home equity line of credit. The loan amount 25,000. The loan proceeds paid off almost $20,000 in third party unsecured debt. She received about $3,000 in cash proceeds and was charged more than $2,200 in closing costs.

Unbeknownst to Ms. Manuel, the interest rate was not fixed, but adjustable. The loan had an initial teaser rate of 3.875% for the first month. Beginning in the second month, the interest rate was set at prime plus two percentage points. Prime then was four points.

According to the terms of the note, the first ten years is the draw period and the monthly payments are interest only. The remaining ten years is the repayment period, during which her mortgage payments will substantially increase. The interest rate and monthly payments have increased dramatically over the past two years, with the increase of the prime rate. Her initial monthly payment was about $100. But it's more than doubled to the current payment of $215. Now, who is the lender? The lender is IndyMack Bank, a federal savings bank.

Now, how is this loan underwritten? Although she told them she was getting only $541 per month in Social Security, the loan application in the lender's file falsely states that her monthly income was 1100 in Social Security. IndyMack -- I got a copy of the loan file from the lender.

IndyMack Bank issued a conditional approval letter -- approval notice to the mortgage broker.

Among the conditions was an instruction that the mortgage broker obtain a copy of the Social Security letter with the income blacked out. In the lender's loan file is a copy of a Social Security award letter with the income, indeed, blacked out. IndyMack didn't just ignore the information about her actual income, it actively instructed that the information be concealed.

This loan never should have been made. No lender should make an ARM, much less an exploding ARM to someone on a fixed income. Given her FICO score of 703, no lender should have charged her an interest rate of prime plus two. No lender should have done a no doc loan or stated income loan to someone on a fixed income, especially when the source and amount of her income can be easily documented.

Finally, no lender should instruct the mortgage broker or anyone to black out or mark out the proof the borrower's income. And although the lender was very careful not to document her actual income but was careful to document the value of her home with the home's evaluated at 84,000, this lender knew that when she inevitably defaulted on the loan, it could proceed with foreclosure and profit enormously. She's struggling to pay her ever increasing mortgage payments, facing possible foreclosure, the loss of her home, and all the equity in it.

She wanted you to hear her story today because she's upset about what happened. She's never been in this situation before. She's worked hard her whole life, always paid her bills on time, and has never faced the possible loss of her home.

We're going to do everything we can to make sure she doesn't lose her home. We're here today to ask that you do everything you can, including using your authority under section 1639 to prevent other lenders from doing the same thing that IndyMack did to Ms. Manuel.

MS. BRAUNSTEIN: Thank you.

MS. BROWN: Thank you for this opportunity to let her story be told.

MS. BRAUNSTEIN: Thank you. Okay. Ms. Ashby?

MS. ASHBY: Thank you, Madam Chair. Good afternoon. My name is Adrienne Ashby. I'm an attorney with the Senior Citizens Law Project at Atlanta Legal Aid Society. I have with me today my client, Ms. Agnes Martin.

Ms. Agnes Martin is a 76-year-old senior citizen who is disabled. Her only source of income is from Social Security. She's a foster mother, and she has custody of her seven-year-old grandson. Before Ms. Martin retired, she worked as a hotel maid. Ms. Martin has owned her home in Forest Park, Georgia, for the last 27 years.

In November 2003, Ms. Martin took out a loan with Freemont Investment and Loan Company. This mortgage loan refinanced a previous mortgage. Ms. Martin took out this loan because she needed money to bury her father who had recently died. Ms. Martin had cared for her ailing father for the past 21 years until his death in 2003.

Ms. Martin was referred to a mortgage broker. She told the broker that her monthly income was only $904 from Social Security. She also told the broker that she received $844 in foster care assistance payments for the two foster children in her home. Ms. Martin made it clear to the broker that she wanted a fixed interest rate loan.

Unfortunately, Freemont did not give Ms. Martin the fixed rate mortgage that she wanted. Instead, Ms. Martin received an adjustable rate loan in the amount $85,000. Her starting interest rate was 8.3 percent. The loan was structured so that Ms. Martin's interest rates would only increase, possibly to as high as 15.3 percent and would never go below the initial rate of 8.3 percent.

The loan proceeds paid off Ms. Martin's previous mortgage and paid off unsecured debt in the amount of $3,900. Ms. Martin received five hundred -- excuse me -- $5,336.11 in cash proceeds from the loan. She used this money to pay for her father's funeral and burial.

The initial monthly payments on this mortgage comprised 71 percent of Ms. Martin's monthly income. After she paid her monthly mortgage, she had only $262.43 remaining from which to pay her utilities, property taxes, homeowner's insurance, food, medicine, and other necessities for daily living. After two years, Ms. Martin's monthly payments increased to $751, even though her monthly income was only $933 per month. Ms. Martin's current monthly mortgage payment is $930. This leaves Ms. Martin with $3 each month after she's made her monthly mortgage payments.

In an attempt to make it look like Ms. Martin's income was higher than it actually was, the broker considered the foster care payments that Ms. Martin received as part of her monthly income, even though the lender knew that these payments were for the benefit of the foster children. The lender also knew that Ms. Martin would only receive these foster care benefits until the children turned 18 years old. At the time Ms. Martin got her loan, the children were 12 and 15.

This loan should have never been made to Ms. Martin. The lender showed utter disregard for Ms. Martin's ability to repay the loan. Even under the initial interest rate, Ms. Martin's income was insufficient to keep up her monthly payments and to maintain her household. Moreover, an adjustable rate loan should have never been given to someone living on a fixed income. It was inevitable that

Ms. Martin would default on her loan because her income would not keep pace with the increases in the amount of her monthly mortgage payment.

Ms. Martin is now two months and $1900 behind on her mortgage payment, and she worries every day about whether she'll be able to keep the home she has lived in for almost 30 years. Ms. Martin is here today asking that you do everything in your power to require stricter underwriting standards for mortgage lenders so that what happened to Ms. Martin does not happen to anyone else. Thank you.

MS. BRAUNSTEIN: Thank you. Ms. MacLeod?

MS. MACLEOD: Good afternoon. My name is Nancy MacLeod. I'm a housing counselor, and I work with the Home Defense Program at the Atlanta Legal Aid Office in Decatur. I'm here to share my perspective with you because I may be the only housing counselor in attendance, and I feel like I have a unique perspective on consumer education and providing disclosures to potential borrowers.

Consumer education has been an effective tool in protecting senior homeowners who are considering a reverse mortgage, but it has not been as effective in protecting home buyers or in protecting homeowners who are considering whether or not to take out a home equity loan. Consumer education works for reverse mortgages because there are relatively few loan products, the interest rates do not vary from lender to lender, the underwriting requirements are virtually the same from product to product, there are few costs that can vary, and reverse mortgage counseling is mandatory before a consumer can actually apply for the loan.

Counselor can show a senior homeowner the direct benefits and costs for each loan available on the market. The disclosures provided in the counseling session include the reverse mortgage analyses and the total annual loan cost disclosure, and they allow consumers to compare these products side by side. So seniors leave that counseling session knowing which reverse mortgage product is their best option. They're given information on how the loan will impact their financial situation, the long term effect on the equity left in the home, other financial alternatives, and their responsibility should they take the loan out.

Consumer education for first time home buyers is effective if you're trying to teach the basics of home ownership. But it's not effective in teaching consumers how to evaluate a complex array of financing options. Each lender has a different set of financing products, each with their own special pricing and underwriting standards. Non-profit agencies are ill equipped to teach consumers how to evaluate this many loan products. And consumers, many of which have less than a high school education, are ill equipped to make an informed decision when presented with so many different financing options.

Reverse mortgage counseling works because counselors have access to the underwriting guidelines for each loan product. They have a Web-based software with -- that updates regularly for all loan products at their disposal, and they use the software to print out side by side comparisons of costs and benefits for the loans. The borrower receives the information before they proceed with a lender if they decide to actually apply for the loan.

If you're seriously interested in protecting home buyers and homeowners from unscrupulous mortgage lenders and brokers, you might first consider reducing the number of purchase mortgages and home equity loan products on the market, prime and subprime. For the loan products that are truly beneficial to consumers, standardize the underwriting requirements and then the allowable costs, return to the practice of lending to consumers based on their ability to pay during the term of the loan, and provide your housing counselors with a Web-based software that can access information from locally based lenders for their loan products and pricing. And then consumers can use this information to provide the side by side comparisons for consumers.

Make consumer education mandatory. I know that's controversial. Or actually, make consumer education a normal step in the process of buying or refinancing a home. Under these circumstances, consumer education for forward mortgages could provide valued information.

MS. BRAUNSTEIN: Thank you very much. Okay. We'll bring the panel up. Thank you all. Richard Brown, William Vatavuk, Nicole Cotton, Dave Hall, Paula Harrison, and Stella Adams. This is like boys on one side, girls on the other. All right. We'll start with Richard Brown.

MR. BROWN: I want to thank the Federal Reserve --

MS. BRAUNSTEIN: Please -- I'm sorry. Introduce yourself when you start for the court reporter.

MR. BROWN: Okay. All right. Yeah. My name is Richard Brown, and I am -- I'm speaking on behalf of the Community Reinvestment Association of North Carolina. I want to thank the Federal Reserve for having this and giving the community a chance to speak out on some of these issues. North Carolina has a group of seven that has come down -- driven down this morning to speak, and we have several people sitting here on the panel. So I will lead, and then they will follow up on the various specifics. I have a written statement that I want to read from.

But before I do that, one of the things that strikes me on the things I've heard here is that the disclosures are dealing with the benevolent lenders. And then there's another set of lenders. And part of what you will be hearing as it relates to consumers, at least in North Carolina, is that these lenders aren't benevolent. In fact, what they are doing is actively going out and taking advantage of consumer after consumer. And so let me start with my written statement with those thoughts in mind.

The Community Reinvestment Association, acronym known as CRANC, promotes social and financial justice through creative advocacy, television, and radio production. For the record, I am submitting our report, Paying More and Getting Less, an analysis of the 2004 mortgage lending in North Carolina. Our key finding is that disproportionately there is a ratio of more than four to one African-Americans paying more interest in home loans than whites do in North Carolina. This finding has also been reached by a number of other HMDA analysis.

We applaud the Federal Reserve for holding these hearings and for the chairman's position that while financial literacy and consumer awareness are important in preventing predatory lending. However, it is a regulatory responsibility to ensure fair lending. CRANC supports financial literacy through various means, and we continue to insist that more can be done through existing enforcement mechanisms and authority of the regulatory bodies.

Let me talk a little bit about an example. In the recent years, popular adaptations of traditional mortgage loans varying in term as short of 15 or as long as 40 years are available. The structure of these loans are -- have also grown more heterogeneous. In fact, HMDA data's current structure encourages all loans of the same terms or -- is erroneous. Only 72 percent of mortgages -- borrowers actually get 30-year fixed rate mortgages according to Wall Street Journal. And that lower -- That number is actually even lower in western United States.

Adjustable rate mortgages are now a popular choice for many consumers, as are interest only products. And many people are using what they call these pay option ARMs. Amortization varies in these products, as well. Fixed rate interest only loans account for eight percent of loans according to UBS.

In many cases, interest only products bear balloon payments. And in each case, HMDA data is insensitive to the presence of these types of products. So let me get to the recommendations that CRANC would like to offer humbly to the Federal Reserve.

MS. BRAUNSTEIN: Is it possible that one of the other speakers will do that because you're --

MR. BROWN: I'm already out of time?

MS. BRAUNSTEIN: -- out of time.

MR. BROWN: Wow. Okay. All right. Well, I will --

MS. BRAUNSTEIN: You can submit it for the record.

MR. BROWN: Yes, I would like to submit those for the record. Thank you.

MS. BRAUNSTEIN: Thank you very much. William Vatavuk?

MR. VATAVUK: Good afternoon. My name is William Vatavuk, and I've been working as an intern at the North Carolina Fair Housing Center this summer. Economy.com estimates that at least one million homeowners will see their house payments double in the next two years. Now, this study suggests that one in seven borrowers have recently taken out adjustable rate mortgages will have trouble making their payments.

According to your own study, many Americans are confused about the terms their adjustable rate home mortgages and underestimate the amount by which their loan payments could jump. You report that 35 percent of people with adjustable rate mortgages don't know how much their rate could increase at any one time. And 41 percent weren't sure of the maximum rate or payments they could face.

The study further found that people with low incomes and less education are more likely to be unsure of the terms of their mortgages. The North Carolina Fair Housing Center has found that borrowers often believe that they are told by mortgage brokers -- We often hear borrowers say that they were not to worry about the terms of their adjustable rate mortgage because they'd be able to refinance before the adjustment hit. But that isn't always possible for the borrowers we see who have heavy debt loads and little to negative equity in their homes.

Therefore, I encourage the board to use its power to regulate the mortgage market to create a suitability standard for mortgage brokers who are currently responsible for the origination of 70 percent of the mortgage loans but for whom there's no national guidance or standards.

MS. BRAUNSTEIN: Thank you. Nicole Cotton?

MS. COTTON: Hello. My name's Nicole Cotton. I've been working as a legal intern with the North Carolina Fair Housing Center this summer. The North Carolina Fair Housing Center strongly believes that lowering the fee trigger to five percent is appropriate and necessary extra protection. Both Fannie Mae and Freddie Mac adopted guidelines as early as 2000 stating that they would not purchase high cost loans with fees in excess of five percent.

Many major financial institutions in the industry have, therefore, recognized that loans with fees in excess of five percent are prone to abuses if not executed properly. Ms. Bennett is one of our clients. Ms. Bennett, one of our clients, was charged a one percent origination fee and three percent yield spread premium. The center strongly urges the board to include yield spread premiums in the point and feature in the calculation. Thank you.

MS. BRAUNSTEIN: Thank you very much. Dave Hall?

MR. HALL: My name is Dave Hall. I'm also a summer legal intern with North Carolina Fair Housing Center. And the North Carolina Fair Housing Center typically receives four to five inquiries a day related to loan default and delinquency. Ms. Bennett is a typical -- is typical of the types of calls we receive.

Ms. Bennett originally had a fixed rate loan with First Union Bank in 1999. At that time her interest rate was 7.875 percent. Her payments were 725.07 per month. Ms. Bennett sought to refinance her loan in August 2002 in order to take advantage of the lower interest rate environment and wanted a fixed rate loan.

According to the August 23, 2002, weekly survey by Freddie Mac, 30-year fixed rate loans were at 6.27 percent at the time she closed her loan. Ms. Bennett, enticed by the mortgage broker, entered into a 327 ARM without understanding the consequences. The mortgage broker received a $1600 YSP for placing her in this loan product. In 2005 when the loan reset, the same mortgage broker placed her in an ARM that adjusts on a monthly basis and the payments are creeping up at a rate that will soon be beyond her ability to pay.

Ms. Bennett has a credit score that would qualify as A credit, and she also has an excellent employment history. She initially sought to reduce her house payments so that she could complete college and improve herself. Were it not for the mortgage broker who presented herself as a financial counselor, Ms. Bennett could have refinanced to a lower interest fixed rate mortgage with either First Union/Wachovia or the State Employees Credit Union.

She was totally unaware of her options throughout this process. She kept referring to the mortgage broker as a counselor, saying I went to her for counseling, and this is what she told me to do. The counselor made about three percent off each loan transaction half -- transaction, half of which were YSPs for placing her in these inappropriate products. Thank you.

MS. BRAUNSTEIN: Thank you very much. Paula Harrison?

MS. HARRISON: Good evening. I'm Paula Harrison. I came down as a consumer with North Carolina Fair Housing. I contacted them regarding my loan but actually found relief through another entity. But I have to ask the question, being a consumer, and I'd ask everyone in this room. What would you do if you had eight hours to save your home? I had to deal with that question because my journey into predatory lending started in 2001 when I refinanced from a comparable loan into a financial nightmare.

It took four years to rectify the situation. Going through the guidelines that I found through HUD, I actually contacted the lender at the time that I was laid off, and nothing was done. At that point, I realized I was in tremendous problems because of the problems and understanding talking with another non-profit, identified my loan, based on excessive fees that that was the problem. I had excessive fees, and that was what targeted into predatory lending.

After making a complaint with the North Carolina Banker Commission, that was the only reason my broker even talked with me -- my lender talked with me regarding reducing the rate. They reduced the rate from 12 percent to 11.5 percent. Not understanding the nature of the loan, I contacted another entity, National Training Information Tech Center in Chicago who had an agreement with my particular lender.

After talking with -- And I asked the person I spoke with, I said, let me talk with the compliance manager myself. At that point I gave all the findings through North Carolina Housing, all the non-profits that I found, and actually became my own advocate. I feel that once you empower yourself, you can make a difference. Everyone in this room can make a difference to these abuses that's happening.

After speaking with the compliance officer, he reduced the mortgage from 11.5 percent to 7.5, without an attorney, just a consumer who educated herself, not because I wasn't educated, not because I did all the steps that all financial books said you should do. At that point dealing with that and to this predatory loan, the credit has been demolished because I had A-1 credit based on the Center for Responsible Lending at the time I took the loan. And now I'm dealing with fighting a $13,000 balloon payment at the end that the broker found. And actually, the company that I dealt with got 5,000 and then the broker got another 5,000.

So what protection does this committee, this panel have to do to protect the consumers? So I ask the question again, what would you do if you had eight hours to save your home?

MS. BRAUNSTEIN: Thank you. Stella?

MS. ADAMS: Every day consumers across this nation are facing tremendous obstacles. Financial literacy is not the answer. It's part of the solution, but it is not the panacea that all would have it. Disclosures in and of themselves are not the answers. In many cases the disclosures we have today are licenses to steal because if people don't understand the disclosures, they can't react.

They don't know what they're signing away, and they're often signing away their rights.

It is critical that the Federal Reserve use its power to regulate and to put in place suitability standards. We have to stop piling on the responsibility on the borrowers to learn when the market changes every day. And it is an unlevel playing field. They are not equal players in the transaction. The lender has the control. It is not an equal situation where two people with equal knowledge sit down and negotiate. It is an unfair -- They are at an unfair advantage.

Mortgage brokers are now originating the majority of loans in this country, and they are not a part of the transaction. The lender can say, oh, we have the disclosures in here, and we asked for the information, and we can't help what the broker did. And that doesn't help the borrower.

It's the -- The risk is covered on -- It's spread out amongst all the investors and the risk is covered for everyone but the consumer, and it's the responsibility of the Federal Reserve to manage the risk for the borrower, just as the markets are managing the risk for the investor. And how you can do that is to use your power to regulate the mortgage market, to put in place a suitability standard, and to put in place safeguards that protect the consumer from an unfair burden of risk. We thank you for allowing us to come and speak to you today.

MS. BRAUNSTEIN: Thank you very much for making the trip. Thank you to everybody. And Larry Cherry? Is he here? Okay. And Derrick Bozeman? Mr. Cherry, would you like to go first?

MR. CHERRY: My name is Larry Cherry. I came all the way from Chicago because I didn't hear about them when they were in Chicago. But I thought it was important. I'm with the organization called the University of Life Itself.

And I've seen both parts because I was a former real estate broker, and I owned a mortgage company, and I invested in a lot of property. When I realized that I was buying a lot of property that were being foreclosed, I stopped buying property and I set up a not-for-profit organization. And since that time, we've been instrumental in saving hundreds of houses from foreclosure.

The problem is something we haven't talked about today. The credit system really does not give borrowers a fair play and opportunity. Since credit scoring has been introduced, many people who are people who have good income don't have the credit to be able to get the right type of interest rate, so they're paying 12 percent, 13 percent. In addition, mortgage brokers get paid for charging a lot of interest. The larger they charge interest the more yield service premium they get.

So the Federal Reserve, who is in control of all the money, certainly has the power to influence the credit system so that people who are poor borrowers and low income borrowers don't lose their homes simply because they had a credit -- a telephone, cellular phone, and their credit is low because they had a contract cancel or because they had a medical bill and now they're in a whole other rating. Seven years that they're punished with bad credit because they didn't have any money in the first place.

So it's kind of a system that implodes on itself and punishes those individuals who have the least. And for minor infractions, I now throw into loans that cause a lot of problems. In addition to predatory lending, a whole other process of predatory foreclosures is introduced when you have foreclosure mill attorneys that are doing everything they can, illegally in many cases, to take away the rights of borrowers as they move with their home.

In Chicago and most judicial states, you can actually buy a house for 50,000 or 100,000, pay for it for 15 years, owe 20,000. Your house is improved to 150,000, and you can lose the house. And the lender gets to keep all the money, the house, and sell it and make all the profit. How can that be fair?

So you know, it's a time to wake up and realize that we have a lot to change in the system. The credit system needs to be changed totally around. Credit scoring does not work. It's arbitrary. People who are making 50,000 a year, if they only have one credit card that they 800 on that's a $1,000 limit can have a score reduced 30 points. So the credit system doesn't even take into consideration because they don't even know how much money the person is making. So it's a computer model that really is totally unfair, and it's another way of discriminating against those who have the least.

So it's time to make a change in that, as well as in the entire foreclosure process where the laws allow foreclosure mill attorneys to get richer. In Chicago, Cook County, over 100,000 foreclosures in the last six years, and most of them -- many of them were predatory loans where people have no rights. There are probably less than 20 attorneys in the whole state of Illinois who have any idea of how to defend a foreclosure victim. So our organization is about training attorneys to begin to -- assist those attorneys to begin to learn some of the procedures involved in helping somebody who might be in foreclosure. Thank you.

MS. BRAUNSTEIN: Thank you very much. Mr. Bozeman?

MR. BOZEMAN: Thank you. I'm Derrick Bozeman, a former member of the Atlanta City Council here in the city and served two terms, and I worked very closely with Senator Fort and the Atlanta Legal Aid. And I wanted to just disabuse any notion of predatory lending has gone away in the state of Georgia.

In fact, when the new governor came in to make sure that the law that Senator Fort had worked so hard to author and had worked in response to what he was seeing from neighborhoods and constituents that we both serve, this governor made sure that what he did, Sonny Perdue, was to go to every bank in Georgia, it appeared, and got the senior most staff -- I mean, his chief operating officer was the highest ranking official at the local bank. So you can -- What did you expect to come out of that kind of set up? You expected every kind of consumer advocate entity essentially to be gutted. You would have thought that there would have been a greater sensitivity.

Let me just say this. Predatory lending in its pernicious nature is very serious. You've heard what some would say, well, these are just anecdotal inferences that the people you see, hopefully, an aberration of what really happens. But no, they are the people who represents too many and too often of the folks that we see on a daily basis.

I just left a few minutes ago from a 60-story tower Bank of America building, two blocks up from this one.

You know why I was there? Because a church in south Atlanta, not too far from where I live, has a predatory loan -- had been extended -- a church, the house of God, the house of worship has a predatory loan. What makes it predatory? One, they did not have the ability to repay it. It was a loan that was extended to them by Bank of America, which basically called for them to make a $6,000 payment on a $1.5 million loan for the first three months. Then it went up to $12,000, with a balloon payment of now 138,000 after 15 years. And so that's what's happening in Georgia today.

And so, if they will do it to a church after the legislation that Senator Fort put forth -- I also authored legislation because we know that all politics is local. I authored legislation that even put in penalties when we found banks -- and these are main line banks that oftentimes do this -- engage in those practices that they couldn’t do business with the city of Atlanta where we deposit of hundreds of millions of the taxpayer's dollars.

It was in place every bit of two weeks before a general assembly put in place a preemption from local governments to put any kind of regulatory legislation in as it relates to banking. So the Federal Reserve do have a responsibility. You are the vanguard to keep these kinds of -- to regulate property because states have shown, if given an opportunity, certainly here in Georgia, what they will do everything that they can to help predatory lending flourish. We didn't run anybody out. The people who should have been ran out are still here. They're doing a disservice to this community, and it often explodes in the lives of people in very rare ways.

We've been able to reform some loans, but oftentimes it's after the hearse have driven that person to the cemetery. They're still living under conditions of pressure and stress that oftentimes these loans put them under. So we thank you for the opportunity to make a statement.

MS. BRAUNSTEIN: Thank you very much. And I'd like to thank everybody for today. And I especially want to extend our deep appreciation to the Federal Reserve Bank of Atlanta and their staff, in particular, Joan Buchanan, Juan Sanchez, Jennifer Grier and everybody -- and Wayne Smith, and everybody else who helped make this happen today. And with that, we are adjourned.

(Whereupon, the meeting was adjourned at 3:46 p.m.)

C E R T I F I C A T E

STATE OF GEORGIA)
)
COUNTY OF FAYETTE)

I, CHARLENE M. HANSARD, being a Certified Court Reporter in and for the State of Georgia, do hereby certify that the foregoing transcript, consisting of 226 pages, was reduced to typewriting by me personally or under my direct supervision, and is a true, complete, and correct transcript of the aforesaid proceedings reported by me.

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WITNESS MY HAND AND OFFICIAL SEAL this _____ day of ____________, 2006.

____________________ _______
CHARLENE M. HANSARD, CCR-CVR
CCR No. B-2341

[SEAL]